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October 25-28, 1998

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Allied Academies, Inc.
An International Non Profit Association
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PO Box 2689, Cullowhee, NC 28723
Voice 704-293-9151; FAX 704-293-9407
www.alliedacademies.org

Volume 5, Number 2 1998

Proceedings of the International Academy for Case Studies

October 25-28, 1998
Las Vegas, Nevada

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The Proceedings of the
International Academy for Case Studies
are published by the
Allied Academies, Inc., PO Box 2689, Cullowhee, NC, 28723.

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ARTHUR WRIGHTSON V. PIZZA HUT OF AMERICA: A CASE OF SEXUAL HARASSMENT?

Gerald E. Calvasina, University of North Carolina Charlotte
Joyce M. Beggs, University of North Carolina Charlotte

CASE DESCRIPTION

The primary subject matter of this case concerns human resources management. Another secondary issue is sexual harassment, and more explicitly same sex sexual harassment. Other secondary issues include employment law and the proper management response to sexual harassment complaints. The case has a difficulty level of four, appropriate for senior level courses of human resources management, employment law, and business and society. The case is designed to be taught in either a 50 to 120 minute class and is expected to require two hours of outside preparation by students.

CASE SYNOPSIS

Arthur Wrightson, a sixteen year old heterosexual male, worked for Pizza Hut as a cook and a waiter in Charlotte, North Carolina. His immediate supervisor, Bobby Howard, and five of his coworkers were male and openly homosexual. Three other coworkers were heterosexual males. Arthur and his heterosexual coworkers allege that Howard and the other homosexual male employees began to sexually harass them. It was made clear to Howard and the homosexual employees that the harassment was unwelcome.

Jennifer Tyson, the manager of the Pizza Hut restaurant, and her assistant, Romeo Acker, were aware of the harassment and of the objections to it. Arthur's mother also began to complain to the managers. Tyson had witnessed some of the allegations and admitted to Arthur's mother that she was aware of Howard's actions. Tyson called a meeting and "ordered the homosexual employees to stop harassing" Arthur and his coworkers. The homosexual employees made jokes about the "possibility of a federal sexual harassment suit," and the harassment not only continued but also "intensified." No formal action was ever taken against Howard or the other homosexual employees by Pizza Hut management.

Arthur Wrightson filed suit against Pizza Hut in the U.S. District Court of North Carolina. He alleged that he had been sexually discriminated against in violation of Title VII of the 1964 Civil Rights Act. The complaint alleged that Arthur was subjected to a "hostile work environment" in violation of Title VII in accordance with the Supreme Court's decision in Meritor Savings Bank v. Vinson.

THE TOLEDO FLYING CLUB (PART TWO)

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CASE DESCRIPTION

The primary subject matter of this case concerns business strategy. Secondary issues include non-profit organizations, accounting, finance, marketing, small business administration and ethics. The case has a difficulty level of three. The case is designed to be taught in approximately two one hour sessions and is expected to require two to four hours preparation depending on which questions are explored by the instructor.

CASE SYNOPSIS

The case concerns the general aviation industry and whether Flight One, a fixed base operator (FBO), should diversify its operations by absorbing a local flying club, The Toledo Flying Club. Flight One provides charters and aircraft maintenance while flight training and small aircraft rental is provided by The Toledo Flying Club. Flight One's owners must decide if they want to diversify into flight training and aircraft rental. If so, is absorbing the flying club the best way to pursue diversification? What changes are needed (if any) to the operation of the flying club and Flight One.

The case should be of interest to management, finance, accounting, marketing and entrepreneurship instructors. This case has elements of strategic planning, ethical conflicts, financing, and tax law application. The case can be used by management instructors as an example of the different stages in the life cycle of a firm (and the industry within which it resides) and the need for change as the environment around an organization changes. Marketing professors would find the elements associated with the customer base and how to expand sales to be of interest. There are elements of conflict of interest for ethics discussion since the club during its decline had evolved into a "for profit" operation disguised as a "non-profit" organization. Finance and accounting instructors will find the leasing of the airplanes to the club and the associated accounting system to be an appropriate subject of study for their students. Finally, there are significant tax questions that would be of challenge in tax courses.

THE OFFER

Gary Fiodore is the general manager of The Toledo Flying Club. He had a meeting scheduled with Tom Swift who owned (along with his wife) the local general aviation fixed based operation (FBO), Flight One, at the Toledo Municipal Airport. When Gary entered Tom's office, Tom was curious as to the box of papers that Gary carried with him. Gary had not specified ahead of time what the meeting was about so Tom assumed it had to do with some general matters between Toledo Flying Club and Flight One.

After the usual pleasantries were exchanged, Gary got down to business. Gary briefly reviewed the history of the club for Tom especially the recent problems with declining membership and activity level of the club. Then Gary dropped the bombshell: the recent decline was so great and he was spending so much of his personal time on club matters that Gary was willing to turn the whole operation of the Flying Club over to Tom (i.e. Tom would become the general Manager of the club). Further, Gary had collected together all of the club's files and documents (the contents of the box) and would leave these with Tom. To say the least, Tom was surprised but had the presence of mind to say that "He needed time to think his decision through and would need to examine the documents first before making a decision."

Gary seemed to be a bit irritated by this but agreed to leave the documents and give Tom a few day's to think it over. As Gary left, Tom's initial reaction was that this was a real opportunity to help build his operation into the full service FBO he had always dreamed of, but was this the right time? The right organization to acquire? What were the legal implications? Did it make financial sense? How does one begin to think this through?

FLIGHT ONE (OPERATIONAL BACKGROUND)

Tom Swift had been flying since he was fifteen years old. Flying was one of his great passions in life. He had obtained most of his pilot certifications by the time he was twenty one years old. He had a great variety of flying experience, having done flight instruction, crop dusting, check delivery, corporate pilot, and unscheduled charter work. He had attended college and finally finished his business degree by taking classes at night between his pilot duties. He had always wanted to own a FBO. Tom Swift and his wife had started Flight One approximately four years ago to provide professional aircraft management for corporations and businesses in the greater Toledo area. He would have preferred to offer a wider range of aviation services but lack of financial resources, the already crowded market for flight instruction (The Toledo Flying Club and Flight Academy), and another company (Sawyer Aviation, Inc.) on the field holding the exclusive franchise to sell fuel limited the markets that Flight One could enter.

Flight One over the last four years had experienced moderate success. It's target market was local small and medium sized businesses that needed light single or twin engine aircraft for their operations but were too small to be able to support their own "flight" departments. Flight one provided maintenance, regulatory compliance, pilots, and general aircraft management of these business aircraft. Within the first year of starting Flight One it became apparent that many of the aircraft under management (which had increased from five aircraft in May, 1992 to fifteen as of June, 1996) could be better utilized. Tom arranged for several of the aircraft to be used for unscheduled

charter work which provided income to the aircraft owners to offset part of the operating costs of the aircraft and a commission to Flight One.

Tom wanted to expand Flight One's activities. He had considered starting a similar service in other medium sized cities within a two hundred mile radius of Toledo but so far none of the situations he had investigated seemed worth pursuing. The alternative geographic expansion was to keep the operation centered at Toledo but to expand into other general aviation activities such as flight training, fuel sales, hanger rental, and aircraft sales. Regretfully these areas were fragmented at the Toledo municipal airport, already taken, or seemed to offer little chance of entry, much less, success.

Flight training was offered by two other operations. Flight training in general was not considered a "money maker" but did have synergistic "tie ins" to other parts of an FBO operation such as aircraft sales, maintenance, and fuel sales. The fuel sales franchise at the Toledo airport was controlled by the airport authority and traditionally had been put up for bids periodically to be controlled by a single firm (currently Sawyer Aviation, Inc.). Three different companies had held this franchise over the last twenty years; each with only limited success (and even losses), mainly because they did not have other activities on the field. Hanger space, as at many airports, was owned and controlled by the airport authority. New small aircraft production had been almost non-existent for the last decade, thus limiting new aircraft sales. Most of used planes were sold directly between pilots without use of dealers.

TOLEDO FLYING CLUB (OPERATIONAL BACKGROUND)

Gary Fiodore left the meeting with Tom Swift feeling a bit dejected. He had been a member of the club from the beginning, and general manager for the last four years. He remembered the good times that he had with the club and the other members over the years. Where had it all gone so sour that he would be willing to give the operation away (lock, stock and barrel) for nothing? He wasn't even sure legally if he could really just give it away (since it was a non-profit corporation) but was willing to chance it so that he could get away from all of the recent troubles he had operating the club.

The early days of the club were great. A group of ten experienced local pilots formed the club in the mid 1970's as a non-profit organization incorporated in Ohio. They each put up $50.00 for the legal work for incorporation and operating officers were appointed by the club members. Each of the ten original members "loaned" the club $500 for operating capital. Two of the original members signed lease agreements with the club to provide aircraft (a two seat trainer and a four seat aircraft for longer flight operations) to rent on a "per-operating-hour" basis with the club assuming the cost of insurance, hanger space, and maintenance. An informal office was set up in the back of the hanger of one of the leased aircraft. A simple accounting system was set up to record aircraft hour usage and collection of payments from the members.

The club dues were to cover the fixed cost of aircraft operation such as hanger space, insurance, annual inspection expenses, and office expenses such as telephone. The hourly rental charge to the club members was to cover the rental rate paid to the owners of the leased planes to the club plus a percentage "mark-up" to cover hourly maintenance and miscellaneous other expenses. Fuel used was to be paid directly by the member using the aircraft with the fuel tanks to be left full after each use.

The first year of operation was a success with high utilization of the two airplanes. The members leasing the airplanes to the club were glad to have others to share the fixed cost of owning and operating their aircraft while the other members had access to good equipment at reasonable rates. Perhaps the club was too successful! Word spread about the club and other pilots wanted to join. Expanding the membership of the club beyond the original ten members posed some very important questions. What of the additional aircraft needed? What of requirement for flight instruction especially for student pilots?

After much discussion, the club did expand its membership with hourly rates increased and monthly dues decreased to a minimal amount (this was more consistent with what the new members were use to when renting from regular for-profit enterprises). Flight instructor fees were paid into the club treasury and deductions made for liability insurance and a commission to the club with the residual (approximately 80% of the total) paid back out to the flight instructors.

Within three years, the club’s membership base had expanded to one hundred members of which fifty were very active. Additional aircraft were obtained on lease from some of the club members which was advantageous for the member providing the aircraft. Soon the club had six aircraft under lease which was a small enough number to provide for good utilization of the aircraft but enough aircraft to prevent too many scheduling conflicts. These were good days. Membership held steady for over a decade but then began to decline during the latter part of the 1980's.

The decline started roughly eight years ago and could be traced to several sources. General aviation had a declining number of new students interested in getting their pilots license. The decline was so great that the total number of active pilots was shrinking since the small number of new pilots did not fully offset the number of existing pilots that lost interest in flying, who were not able to afford the rising cost of flying, lost their medicals, or went to that great airport in the sky upon their demise. This general trend had taken its toll on the club's membership. A further factor affecting the club's local market had been a flight training center (Flight Academy) that was opened approximately five years ago by a young couple. The couple had more enthusiasm and love for flying than experience. It was rumored that their operation was weak financially but they had at least been able to breakeven so far. They provided spirited competition to the club's operation.

One thing that had changed over the years in the operation of the club had been a loss of camaraderie among the members. Most of the original founding members had drifted away. The most active members in the club were those that leased the airplanes to the club. Gary himself was a good example since he currently leased two airplanes to the club and had been the general manager for the last four years. The lease payments to the aircraft owners and the assumption of the fixed overhead by the club were advantageous for the aircraft owners and had made it worthwhile for them to volunteer their time to the running of the club. These members ran the club with little reliance on the general membership. This seemed to be endorsed by the general membership who seldom voiced concerns about the club as long as planes were available when they needed or wanted to fly.

The burden of running the club had become more and more concentrated on Gary. Two problems had especially intensified in the last three or four years for him. First was the increased maintenance problems with the two planes still left in the club as the planes aged (one plane was twenty years old while the other was twenty three years old). New aircraft replacements were out of the question due to either their unavailability caused lack of new plane production or to the high cost of new aircraft (typically $150,000 to $200,000 each). On the other hand, perhaps older aircraft made

sense since the number of active members had dwindled to ten and they typically only flew thirty hours per year. The general club membership did not agree with this last view. they were constantly complaining about lack of aircraft availability (especially when one of the planes was down for repairs) and what seemed to them the general poor condition of the aircraft when they were up and ready to fly. Gary believed that the problems with the aircraft by itself had caused several members of the club to quit.

The second problem Gary was spending a lot of time and trouble with was the turnover in flight instructors. Typically a flight instructor would stay only long enough to begin to be able to help with the club's operations before he was soon gone to corporate flying or to the commercial airlines. As Gary spent more and more time on keeping the airplanes in the air on a day to day basis, with little help from the flight instructors, he had less time to spend on paperwork. He had especially fallen behind on the annual paperwork (example: state and federal tax filings) for the club. Gary was not overly concerned with this since the club was not a "for-profit" business and had never paid any substantial amount of taxes except sales tax which was paid up to date.

CONCLUSION (TOM SWIFT'S QUANDARY)

Tom's initial reaction to Gary's offer was that this was a real opportunity to help build his operation into a full service FBO but was this the right time? The right organization to acquire? What were the legal implications? Did it make financial sense? Tom sensed that this was an important turning point for Flight One, and himself, but needed to think his options and strategies through carefully.

CENTRAL VERMONT PHYSICIAN PRACTICE CORPORATION

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CASE DESCRIPTION

The primary subject matter of this case concerns the outsourcing of information systems, specifically for Billing. Secondary issues examined include health care administration. The case has a difficulty level of three (appropriate for junior level courses or above). The case is designed to be taught in one and one-half class hours, and is expected to take two to three hours of outside preparation by students.

CASE SYNOPSIS

The new president of a small health care organization arranges for a newsletter to be sent to existing clients (patients). She discovers major problems with the mailing list, which was generated from their Billing system. Further investigation suggests that the Billing system, which is managed by a third party vendor, had some major deficiencies that probably resulted in significant lost revenue. If the situation is not addressed, the organization could very well find itself following the footsteps of Oxford Health, which went from apparently healthy to struggling for survival in a matter of months.

INTRODUCTION

Donna Izor, President of Central Vermont Physician Practice Corporation (CVPPC), was concerned. What started out as a small gesture of appreciation to their clients, was turning into a headache. When CVPPC had decided to send out a newsletter in July, Donna had expected the costs to run about $1,000. Now it looked like the costs could increase significantly. More importantly, the problems with the mailing list for the newsletter might indicate deficiencies with important administrative information systems, including Billing. Given their need to reduce costs in the turbulent health care environment, CVPPC could definitely not afford problems with their Billing systems.

THE ORGANIZATION

The Central Vermont Medical Center (CVMC) was formed in 1968 to establish a regional healthcare facility joining the Heaton Hospital in Montpelier, Vermont and the Barre City Hospital in nearby Barre, Vermont. CVMC was a not-for-profit, integrated organization that was comprised of three major components. These included the community based Central Vermont Hospital (which

had a 100 physician medical staff), the Central Vermont Physician Practice Corporation, and the Woodridge Nursing Home. The Woodridge facility (opened in 1993) was a 153-bed nursing home located in Berlin, Vermont. In 1996, CVMC signed an affiliation agreement with The Hitchcock Alliance, an organization comprised of community hospitals and health care organizations, including the Dartmouth Hitchcock health system.

The Central Vermont Physician Practice Corporation (CVPPC) was organized in December 1992. Its mission was to provide access for area residents to high quality primary and specialty care, and management services to physician practices. It employed sixteen physicians, and five mid-level providers who were located at seven sites across the central Vermont region. CVPPC was a fully owned subsidiary of Central Vermont Medical Center, and faced competition both locally and within the larger region.

INFORMATION SYSTEMS AT CVPPC

The main information systems (IS) for CVMC were provided through Central Vermont Hospital. This arrangement provided minimal support for IS functions needed by CVPPC. General hospital applications such as electronic mail and access to the hospital information systems were available, but there was little management or ownership of specific systems to support CVPPC practices. Also, the Director of Information Systems and the Network Administrator for CVH had recently left the organization. Any additional information systems support for CVPPC from the CVH information systems group would probably not have a priority while these positions remained unfilled.

CVPPC owned the Medical Manager software, which included patient registration, appointment scheduling, and billing. CVPCC did not manage all of these systems, however. Instead, they contracted billing services to a third party, Information Systems Solutions (ISS). ISS was responsible for data entry of charges, electronic billing of insurers, payment posting, and report generation. All interactions regarding the Medical Manager systems, such as requests for new reports, were handled by ISS. CVPPC paid ISS over $20,000 per month to manage their Billing functions.

When the relationship with CVPPC and ISS was formed, the manager of ISS was hired to be the administrator for CVPPC practices as well as do the billing. He maintained good personal relations with some of the CVPPC staff, and the CVPPC account was the largest his company handled.

DONNA’S ROLE

Donna Izor had accepted the position as President of Central Vermont Physician Practice Corporation in April, and had started at the position on Monday, May 5. On Wednesday, two days later, the Chief Executive Officer (her boss and the person who had hired her) resigned from CVMC. Naturally, Donna received the news of the CEO's resignation with surprise and some apprehension. She had expected the CEO to act as a mentor for her, helping her to assimilate into her new role. Although Donna had a strong health care and management background, she was new to CVMC. She didn't know how the organization operated. In addition, she wasn't certain how secure her role would be.

Fortunately for Donna, the Board of Trustees for CVPCC reaffirmed the decision to hire her. Once assured her new position was not at risk, Donna worked with other members of CVMC senior leadership and leadership of the Hitchcock Alliance to plan for the transition of duties until a new CEO was recruited.

Donna believed that one of the ways CVPPC could help improve their position was to forge stronger links to their clients. As her first outreach activity, she thought that sending a newsletter that included short medical articles written by physicians, as well as general information, would be a good opportunity to connect with patients. This was something that she had been involved with in a previous position, and she knew that it could be of value. Donna gave responsibility for the newsletter to the Practice Manager. The writing, editing, and layout of the newsletter was done in-house, and Donna was quite pleased with the result.

Donna's first indication of problems was when she saw the boxes of mailing labels. The mailing labels had been supplied by ISS, the company that ran the Billing system for CVPPC. When she checked with the Practice Manager, she was told that there were approximately 30,000 mailing labels. Donna's immediate reaction was disbelief. The population of the service area (central Vermont) was less than 60,000.

"What? Why are there 30,000 labels? We certainly don't have any where near that many patients," she inquired. Donna was told that there were some duplicates in the mailing list, but that ISS was fairly confident in the accuracy of the labels.

Through further questioning, Donna learned that ISS had set up separate databases for each practice. That meant, for example, that a woman who received routine check-ups would be in the Primary Care database. If she became pregnant and went to a CVPPC obstetrician, she would be added to the O.B. database. After her child was born, she would be added to the Pediatrics database if she chose a CVPPC pediatrician.

Every time CVPPC set up a new practice, ISS would set up a new database. In addition, there seemed to be some deficiencies in terms of ensuring data consistency across the databases. A client might be recorded as Elizabeth in one database, as E. in another, as Betty in a third, and so on. Similarly, an address correction made in one database might not be changed elsewhere if the individual was also listed under different practices.

When Donna questioned how they were planning on handling the duplicates, she was told that the clients were asked to contact CVPPC if they received more than one newsletter. The responses from clients could be used to help identify duplicate entries in the ISS databases. Donna knew that receiving duplicate newsletters, with different spellings of the same name, would appear unprofessional. She was assured by Public Relations that, at this point, it would be the best way to handle the situation.

As events evolved, Donna noticed that many calls were coming in from patients with changes or notification of duplicates. She discovered that some of the newsletters were sent to deceased individuals; family members had called to explain. Furthermore, a request added under the return address for "Address Service Requested" resulted in thousands of undeliverable newsletters being returned by the U.S. Post Office at a charge of $0.80 each.

WHERE TO GO FROM HERE?

As Donna completed the 45-minute drive home that evening, she had a lot to think about. As she saw it, the newsletter incident raised two very important issues. First, how much was this going to cost, both in terms of dollars and in terms of the intangible costs of a loss of confidence on the part of their valued clients? Donna now expected that the tangible costs of the newsletter would be significantly more than the original $1,000 estimate, perhaps as high as $20,000. How was she going to explain this unexpected, additional cost to the Board of Trustees? CVPPC was trying to create an image of being efficient and cost effective, and clients might view the postage for the duplicate mailings as being wasteful.

A second, and potentially even more important issue, was related to the Billing system itself. The errors and inconsistencies in the mailing labels led Donna to question just how good the Billing systems were. When the Collections department called some customers, the customers responded that that they had not received a bill. In the past CVPPC had tended to discount these explanations, but perhaps they were correct. Donna knew that if CVPPC was not billing their clients correctly, they were not collecting funds that were due. The need to re-bill insurance companies when errors were made in registration information was also causing a delay in collecting funds.

The more she thought about it, the more questions came to mind. Why were new records being generated for existing patients, just because they used services from a different practice? What could be done immediately to improve the system so that other mailing label needs would not result in the same problem? Who had access to the Billing information? The CVPPC employees from within each practice, or just ISS employees? Was this a staff training issue? Was $20,000 per month a reasonable charge for Billing? What could be done to restore confidence in the information systems of the practices?

Further questioning by Donna had revealed that other companies had put in bids to take over the Billing function for CVPPC during the past 12 months. In addition, the organization had also recently considered bringing the function in-house and had evaluated some Billing software packages. In fact, a woman had been hired several months ago as a Billing manager, and some computer equipment (hardware) had been purchased in anticipation of administering the Billing internally. Since CVPPC had not purchased any Billing software, however, the Billing manager, whose experience was in charge entry and billing for a small practice, was currently working on other projects.

Donna knew that this issue would have to be addressed, and quickly. Unfortunately, it seemed that she had at least a dozen other, equally important situations to deal with. In addition, she was new enough at CVPPC that she really didn't know all the players very well. On the one hand, she didn't want to appear too aggressive and to go against the culture of the community hospital. On the other hand, she knew that CVPPC was fighting for financial survival, and an efficient and effective Billing system was crucial. She was hoping that a good nights sleep might help her decide how best to approach the situation.

LOTEC TACKLE COMPANY - CASE A

F. Stuart Wells, Tennessee Technological University
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CASE DESCRIPTION

Primary subject areas: information technology managerial issues - information systems analysis and design - electronic commerce. Course levels include junior, senior, and master's. Because of the breadth of issues in this case, it can serve several objectives; it may be used in a general MIS course to typify the organizational and behavioral challenges faced by small businesses as they infuse information technology into the company's workings; given the processes detail, it is ideally suited for small business systems development where MIS students can design and implement a working order entry/processing and inventory management system using popular microcomputer software tools. The complete case is rich with detail that allows students to assimilate the organizational and behavioral issues, identify and address several decision points, conduct data flow analysis, and formulate recommendations. Consequently, the scope of the assignment will determine the time and resources needed to accomplish the task. Minimally, two hours of preparation for an issue-discussion in a one-hour class is typical. Because of the flexibility and range of possible assignments requiring systems development, the case may be the basis for a semester-long project involving feasibility analysis, logical and detail design, networking issues, database design, software generation, testing, and user documentation. The tendency of the ill-prepared student will be to jump at the superficial opportunity to "automate" the existing system in attempt to eradicate symptoms; in reality, the case deals with complex issues requiring significant effort to ferret out the true problems, to translate and enhance the president's vision into a workable system. The teaching note suggests several assignment scenarios, ranging from questions to varying degrees of systems development work.

CASE SYNOPSIS

LoTec Tackle is a fifty year old family business that has experienced dramatic growth and profitability. A somewhat typical scenario where demand for its product has provided untapped opportunity as well as neglected market share, the company is now faced with identifying and solving several operational problems. The significant growth in product demand has not been matched with needed improvements in the critical transaction processing system. In fact, the firm may be perched on the threshold of disappointment.

Recognizing that all is not well, the patriarch's college educated grandson, Matthew Logan, now the company's president and general manager, has raised many questions, much to the dismay of other family members. He has indeed taken a bold step; he has hired a consultant to review the company's operations and identify concerns and problem areas. Dr. Sarah Jones, a former professor of Matthew's, and a small business technology specialist, has undertaken the review. In a preliminary meeting with two of the managers, Jones was told rather tersely, " why fix it if it ain't

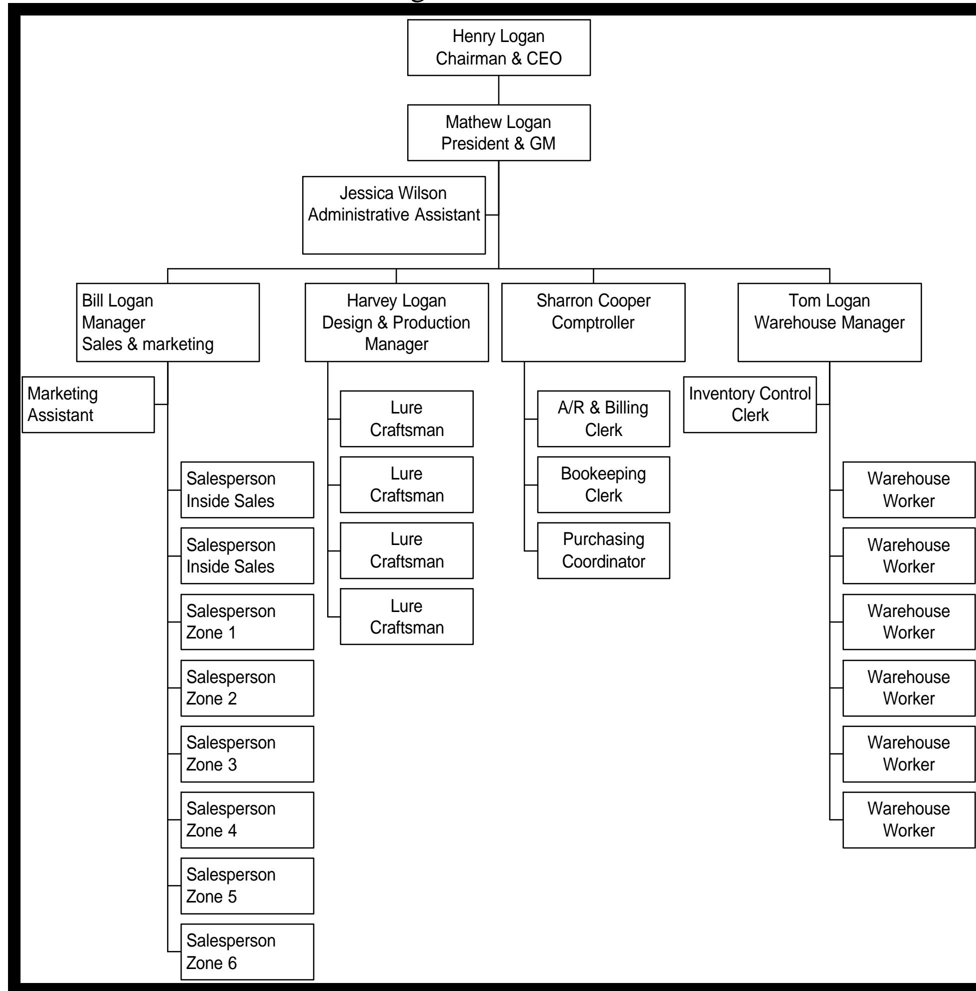
broke. We're making lures we're making money! Besides, what do you know about fishing lures?" Maintaining her cool, Jones said to herself, "LoTec, though an acronym from the founders' names, was a perfect name for this company."

INTRODUCTION

In 1948, Henry Logan began crafting freshwater fishing lures and selling them in his small bait and tackle shop near Nena Bend, Arkansas. Little did he know that, by the 1970's, his talent would be the basis for one of the most sought after, yet difficult to obtain, lines of fishing tackle. During a vacation to Tarpon Springs, Florida, in 1963, Henry met Victor Tecco, a charter boat owner and avid saltwater fisherman. Over a three year period the two men became good friends and in 1967 they formed a partnership to start LoTec Tackle Company, to produce fresh and saltwater lures. For the next decade, every lure sold. The Logan and Tecco families enjoyed the business prosperity and their children and grandchildren became active in the management of the company. Shortly after Victor Tecco's untimely death in 1977, the Logan family bought the Tecco family's interest in the company. With the realization that the company could grow without losing the uniqueness of the product and without compromising the quality of their handcrafted tackle, expansion occurred incrementally. The business was so successful that today it has twenty-four employees at the company's manufacturing and distribution site in Nena Bend and has six independent sales representatives aggressively selling the lures to selected sporting goods stores and bait houses coast-to-coast. Periodically the company will employee part-time workers to assist with warehousing and distribution work. LoTec occasionally even receives unsolicited orders from a few European stores. The company receives many calls from end-customers wanting to place orders, or to find a source of supply. New customers are told to send a request in writing with a check enclosed for their first purchase. Often, these orders are as large as some for some small shops; but the company has never really taken this kind of sale very seriously. LoTecs are never found in discount stores. They are considerably more expensive than typical lures and very highly regarded in the market. A sporting magazine did a story on LoTech a few years ago and stated, " LoTec lures are expensive, reflect the highest quality imaginable, and downright hard to get. A snagged LoTec lure can ruin a day of fishing a fisherman will take up scuba diving just to get the lure back! In fact some folks have even chosen to eat the fish and frame the lure!"

Today, most of the lures are designed at Nena Bend and completely manufactured under contract by several firms in Mexico and Indonesia. Some "blanks" are imported and "finished" at Nena Bend. These are mostly the expensive large saltwater lures and limited edition freshwater lures. Even with the international exposure and dramatic growth, quality is paramount, and each lure must meet the company's strict standards. After all, LoTec lures are synonymous with quality.

FIGURE 1
LoTec Tackle Company
Organization Chart



In spite of the company's dramatic success, Henry's grandson, Matthew Logan, the company's new president and general manager, realizes that there are some serious problems. At the annual company retreat recently, he said, "We've been doing the same thing for fifty years - just more of it each successive year. We've been profitable. Very profitable! Consequently we think we're doing everything right. There's new competition, there's new technology, and there are new opportunities for us to continue on our path of growth and prosperity. Granted, we don't want to "mess-up" a good thing. But we must anticipate the future, and we must cautiously react to demand and better serve our customers. I am not convinced that we are doing our best." Henry Logan bristled at the mere hint that things were not perfect.

Matthew Logan announced that he had employed a consultant to review the current operations in an effort to identify some problems and operational concerns. Unbeknownst to most employees, the consultant had already conducted extensive review of the operating systems, order entry, order processing, inventory, and so forth, over the past several weeks focusing on the flow of

data and orders through the company. Matthew planned to present the findings to the company employees at a meeting a month away.

SUMMARY OF CONSULTANT'S REVIEW

After performing a preliminary business analysis for LoTec Tackle, the consultant noted the following items of concern:

- Many orders were shipped significantly later than originally promised. The company has grown to a point where it is difficult to know each customer well enough to predict overall demand for products.
- Over 4% of the orders were improperly filled. This includes errors of omission, substitution, and shipping items not ordered.
- Between 1% and 2% of all shipments shipped to the wrong customer.
- When problems do occur there are no standard procedures for handling them. Generally the company takes the customer's word about mistakes and ships additional or replacement items overnight. (If they are available)
- The company suffers from excess stock and stock outages as a result of both unanticipated sales and vendor delays in shipping.
- LoTec is quite inconsistent in its procedures for dealing with customers. Where one may receive a bonus pack of promotional lures with each dozen packs purchased at regular price, another may receive nothing at all in the way of promotional items.
- LoTec has grown from a basement business to a two million dollar a year enterprise with little change in its organizational structure. It is a large "small business."
- Paper trails are inconsistent and formal audit trails are non-existent.
- Sales, A/P, A/R, and G/L transaction processing is inefficient and error prone. Worse yet, due to the lack of controls, many errors are not discovered for quite some time if at all.
- Information technology is virtually non-existent; a fax, copiers, three older model microcomputers used strictly for limited word processing, with the exception of Matthew Logan and Sharon Cooper who do generate spreadsheets and graphs.
- Paying six outside sales personnel standard commissions when stores place direct orders was questioned.
- There is no systematic method to handle direct orders from end-customers.
- End-customer orders now represent 20% of all orders, but amount to less than 4% of gross sales. Profit margins are much higher on end-customer sales. This market segment remains virtually untapped.
- Average number of product models in inventory is one hundred.

Upon further analysis of her findings and creation of data flow diagrams of the current system the consultant noted the following additional areas that would probably require attention:

- Orders are received from outside salespeople, directly from both existing and new customers, as well as inside salespeople. Further, these orders are received via telephone, Fax, the U.S. Postal Service, and inside salespeople with virtually no way to track the quantities ordered by order method.

- Over eighty percent of all orders are hand written, leading to numerous mistakes. i.e. even the sales force isn't consistent in filling out orders as some salespeople slash alphabetic O's, others slash numeric zeroes, while others don't slash either.
- Rejected orders and out of stock notices are often held over two weeks before they are sent out to customers and salespeople. Some are never sent.
- The updating of inventory cards is often delayed until time is found to do so. This causes problems in filling orders and often results in misinformation about item availability.
- Salespeople frequently complain about delayed and incorrect commission checks.
- The current A/P system is too inefficient to allow management time to take advantage of prepayment and on-time payment discounts.
- Most processes identified in the data flow diagrams are labor intensive and error prone resulting in lost revenue opportunities as well as higher direct and indirect labor costs.

FIGURE 2
Context Diagram

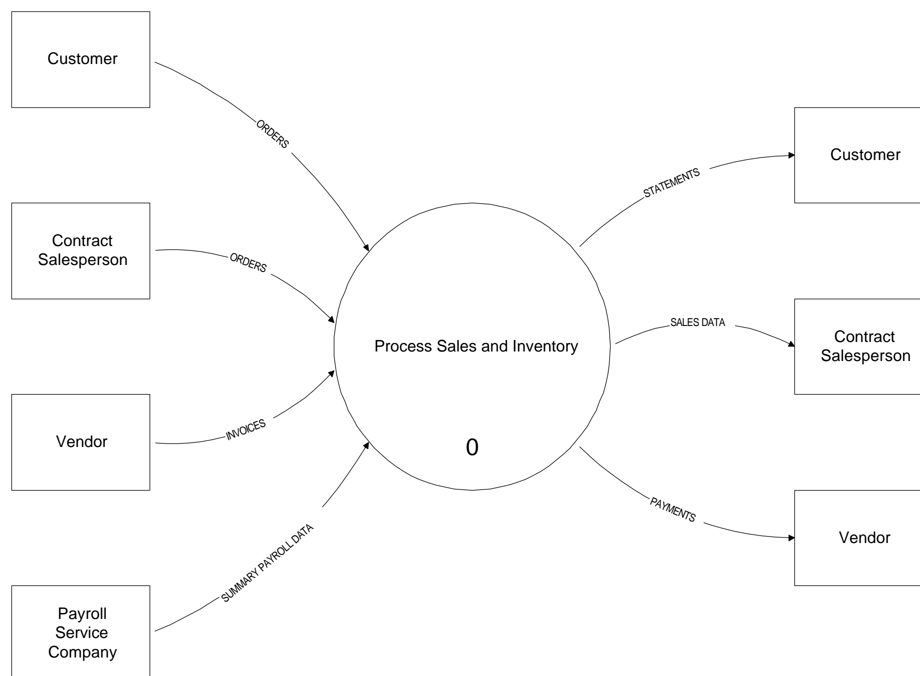


FIGURE 3
Level 1 DFD

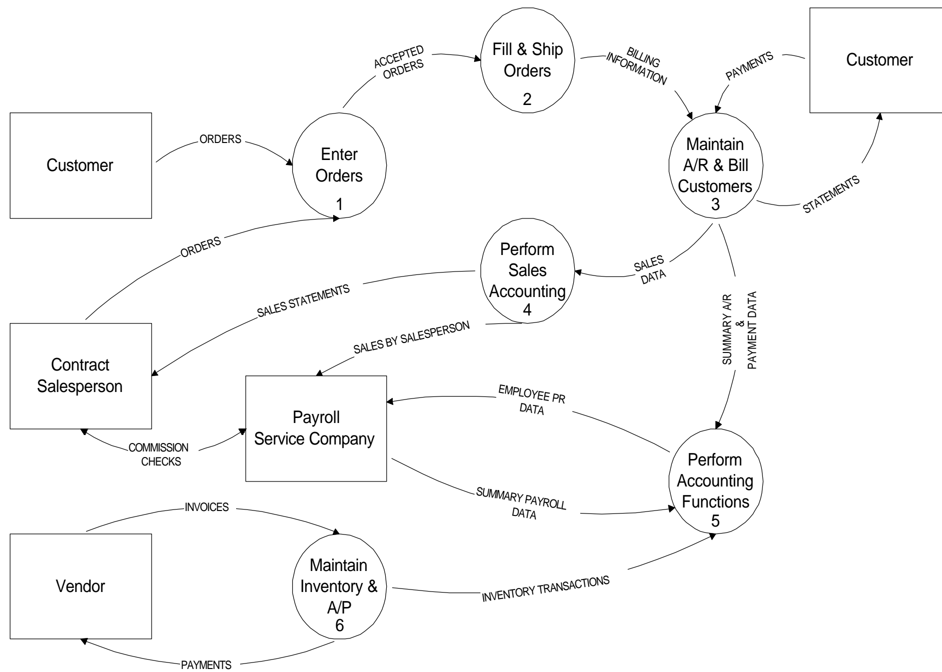


FIGURE 4
Enter Orders

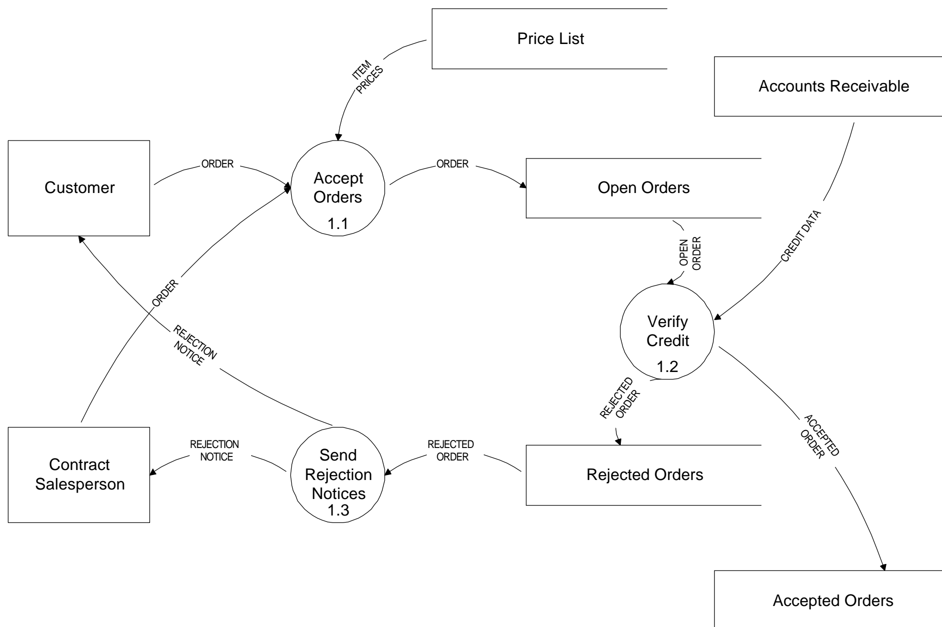


FIGURE 5
Fill and Ship Orders

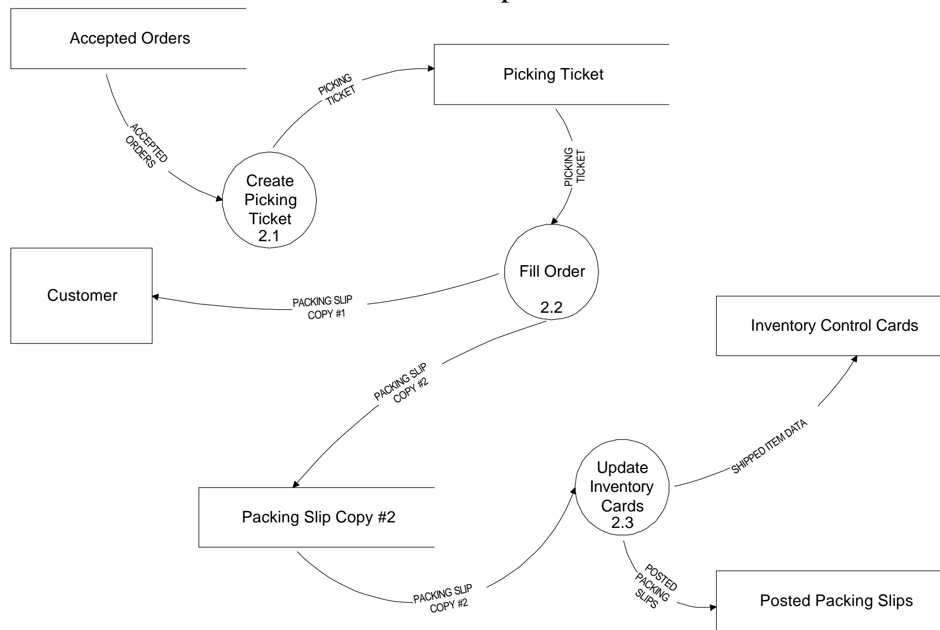


FIGURE 6
Maintain A/R and Bill Customers

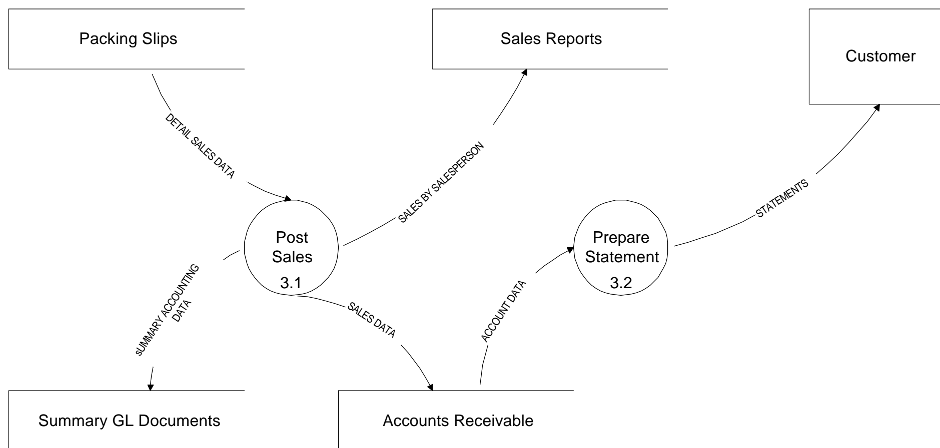


FIGURE 7
Perform Sales Accounting

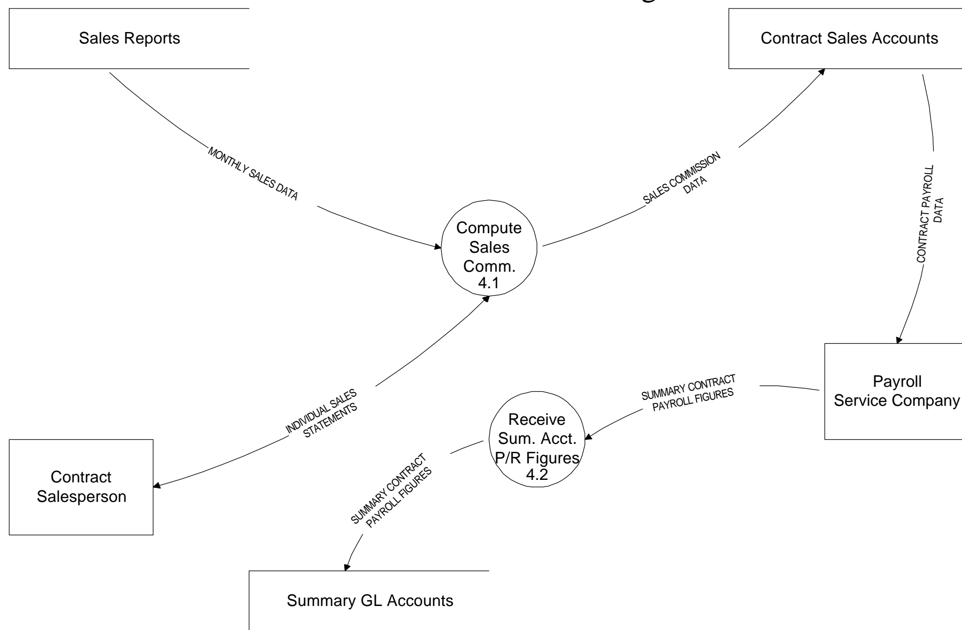


FIGURE 8
Perform Accounting Functions

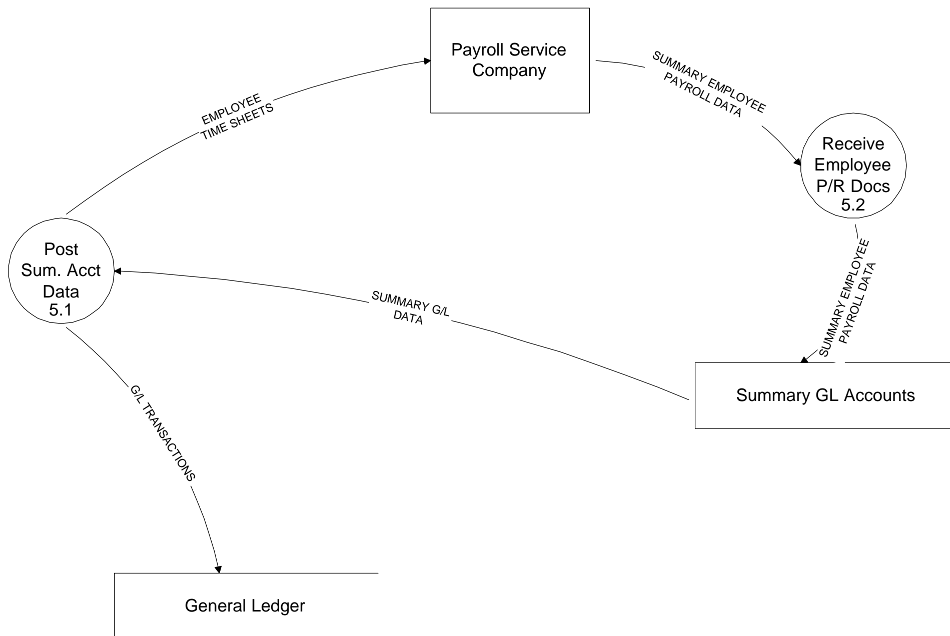
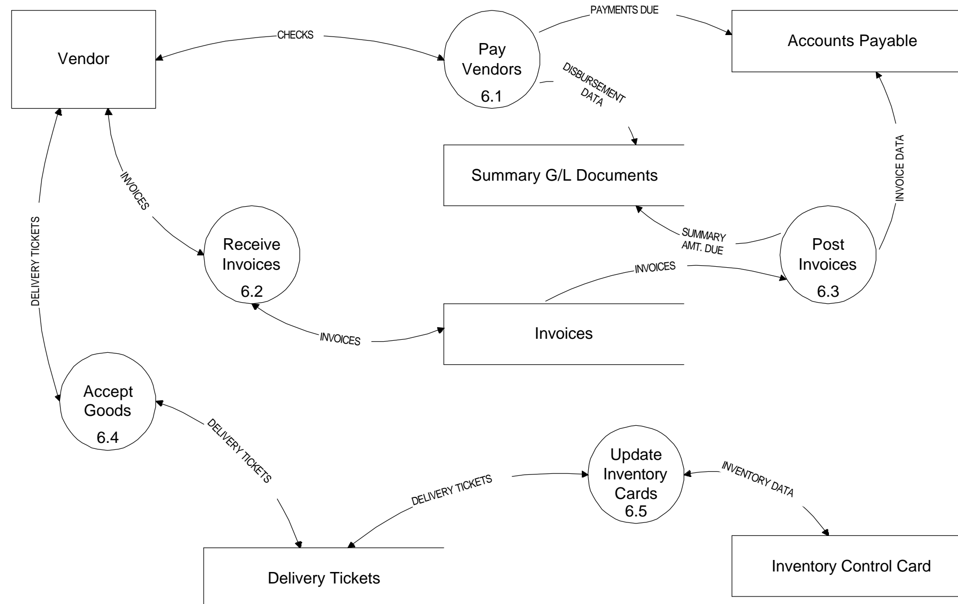


FIGURE 9
Maintain Inventory and A/P



THE MEETING

Saturday morning was an odd time to call all of the full time employees together, but Logan felt it was best to address the entire group at one meeting. Every full time employee was present that morning, much to Matthew's surprise. He opened the meeting by stating " I want all of you to know that we have a great company; we have great people and great products, but my recent review of our operations and processes substantiate my perception that our methods, systems, and processes do not allow us to do our best in getting our product from production to the end customer in an efficient and timely manner. We do need to make some changes I should say 'some improvements.'" I firmly believe that we need a computer based order processing and sales support system that will help each of us to better do our job. Let me assure each of you that no jobs will be eliminated. My goal is to increase sales revenue by addressing efficiency and effectiveness. Furthermore, I see this change as a two phase process: first, I want to take advantage of relatively inexpensive technology to support basically what we are now doing; second, I want to explore innovative possibilities that will allow us to do some new things without losing sight of the fact that we are a tackle company. I am going to look at broadening our product line to include related fishing merchandise, rods and reels, tackle boxes, fishing vests, gift packs of lures, and so on. You know, we're really not a manufacturer any more. We design and contract the production, or buy carefully crafted products made to our quality standards and branded as LoTec and we sell and distribute. We are actually a very simple business; we have been lucky that competition has not threatened us but it is only a matter of time. There is too much money to be made with new business, and consequently new market share. In particular, the end-customer has been desperately trying to deal with us directly, and we have been committed

to six independent sales representatives who see us as a cash cow, while also selling merchandise from other companies. We have been our own biggest problem."

Of immediate priority is the creation of a system that will give us the order taking to order shipment capability. Our consultant has analyzed the flow of data in our company and has stated that the data flow is our biggest problem. Data gets changed, gets lost, gets forgotten, and is often routed over different paths different times. It is not consistent and certainly not reliable. I also want to better serve the end-customer our channel of distribution is as primitive as our order processing system. We can then look at product line growth."

FIGURE 10
Sample Sales Order

LoTec Tackle Company
Rt. 3, Box 202
Nena Bend, Arkansas 71799
(501) 555-1212 fax (501) 555-0000

Purchase Order No. Verbal-07/17/98

SALES ORDER

Sold To
Name Putnam Boat Dock
Address Mill Creek Rd
City Hillside St TN ZIP 38501
Phone 931-555-1212

Ship To
Name
Address Same
City St ZIP
Phone

Qty	Units	Description	Unit Price	TOTAL
4	Cases	A7104	96	384.00
6	Each	STRB-XL	15.50	93.00
1	Each	XM-PRES01	36.50	36.50
2	Cases	TRØLSPEC010 Assrd. Clrs	132.00	264.00
		Throw in a value pack - N.C.		

SubTotal 1077.50
Shipping & Handling 16.00
Taxes State TN 94.28
TOTAL 1187.78

Payment Details
- Check sent today
- Cash
- Account No.
- Credit Card

Name
CC #
Exp Date

Shipping Date

Approval

Date
Order No
Sales Rep
Ship Via

Notes/Remarks
Send ASAP - last order was late. Be sure check is received prior to shipment!

Logan went on to share the consultant's findings with the employees. Some of the workers appeared relieved with Logan's words. He was careful to keep stressing that the system was failing not the individuals. Logan ended his meeting by answering a few questions. Tom Logan perhaps best reflected the anxiety of the group by asking, "Matthew, you know many of us only finished high school .and some didn't even finish. You know completely well that most of us could not find another job. Do you really think we can work with something like you have described? I don't know anything about computers." Logan simply smiled and said, "absolutely, Tom. I promise you."

THE VISION

Matthew Logan sat at his desk thinking about the recent meeting with the company employees. Looking down at the old desk, he thought about all the years his grandfather sat at the very same desk, designing lures and running the business. Matthew had guilt feelings for sending chills throughout the company and, quite frankly, he wondered if he had made a big mistake. Most of these people are family, he thought; and work ethic and loyalty could not be surpassed at any company. But he knew that LoTec could grow from a two million dollar sales operation to twenty million. Efficiency and effectiveness were words that seemed so academic, but so appropriate as he pondered the company's growth. He knew that some current problems had to be fixed, but he also realized that there had to be some new opportunities for innovation to capitalize on the reputation of LoTec products.

As Matthew slipped on his herringbone lambs-wool jacket, he recalled ordering it from a popular upscale New England store using the toll free number provided in their ads. He also remembered seeing an Internet address in the latest flyer from the company, so he was now thinking about going home and logging onto the company's site to maybe do some shopping.

A STUDY IN GOVERNMENT POLICY CAUSING BUSINESS DISASTER: THE NEW ORLEANS CASINO PROJECT

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ABSTRACT

In June, 1992, the Louisiana legislature authorized a single, land-based casino in New Orleans and designated the Rivergate site, which is owned by the City of New Orleans as the location of the casino. At the time it was assumed that this would be a successful business operation, given that New Orleans was a popular tourist destination and successful gaming operations were appearing around the country. Six years later the half finished permanent casino stands empty behind a chain linked fence. The temporary casino closed due to bankruptcy in November 1995. The failure of the New Orleans gaming project occurred while other gaming projects were flourishing in other parts of the country. The purpose of this case study is to examine the combination of legal, regulatory, political, and financial factors that contributed to the failure of this project.

Part one contains a narration of the facts of this case from the inception of the land-based casino plan through the current bankruptcy proceedings. Part two contains various analyses of these facts up to the bankruptcy filing. First, we examine the political and regulatory problems that caused a lengthy delay in starting the project. We discuss the confusion between the City of New Orleans and the State of Louisiana over the duality of the RFP process. Each entity issued an RFP for different aspects of the project and granted the winning bid to different bidders. The ensuing problems over the RFPs caused a lengthy delay in selecting the same bidder for both RFPs. Even when Harrah's Jazz was selected by both the State and the City, there was a delay in starting the project. A lease was executed between Harrah's Jazz Company and City of New Orleans in March, 1994 while a casino operating contract was executed with the State of Louisiana in July, 1994. This delayed the opening of the temporary casino, which was to provide a portion of the funding for the permanent casino and generate tax revenues for the different governmental entities.

Secondly, we examine the requirements of the contract that was signed by Harrah's Jazz Company, the winning bidder. We discuss some of the factors that resulted in the failure of the temporary casino, including its physical location, the restrictions on the amenities it could offer, and the amount of tax revenues it had to generate. We also examine the principal costs that the winning bidder had to shoulder. The New Orleans project placed restrictions on the permanent casino

operations and required substantial monetary outflows to local government in the form of bonus payments

Thirdly, we examine the competitive environment. The New Orleans project was supposed to significantly benefit from its monopoly which we show was the case. Lastly, we examine the mix of debt and equity financing that was proposed and analyze how this led to financial disaster.

CHRONOLOGY OF EVENTS

In June, 1992, The Louisiana Legislature authorized a single, land-based casino in New Orleans and designated the Rivergate site, which was owned by the City of New Orleans (the City) through its Riverfront Development Corp., as the location of the casino. In April 1992, prior to the enactment of this legislation, the City issued a request for proposals (RFP) for a casino on that site. In June 1992, Harrah’s Entertainment, Inc. (HET) submitted a proposal along with a number of other applicants. The City narrowed the list and issued a second RFP in September 1992. HET joined in partnership with Mirage Resorts to make a second proposal. A joint proposal by Chris Hemmeter's Grand Palais Casino, Inc. and ITT/Caesar's World was awarded the right to exclusively negotiate a lease of the Rivergate site from the City. A lease was executed with the Hemmeter group in April 1993.

The State of Louisiana (the State), then issued an RFP in May 1993 to determine who would receive the right to negotiate the Casino Operating Contract to conduct “gaming” activities at the Rivergate site. A new joint venture between HET and the New Orleans Louisiana Development Corporation (i.e., Jazzville) responded to the State RFP in June 1993, and to a second State RFP in July 1993. In August 1993, HET/Jazzville was selected to exclusively negotiate for the Casino Operating Contract with the State. As a result, the Hemmeter group had the lease rights for the only site where legalized land-based gaming could occur in the State while the HET group possessed the exclusive right to engage in legalized gaming activities at that site.

To break this effective legal deadlock between the two aforementioned groups, then-Governor Edwin Edwards, helped mediate an agreement which led to the formation of Harrah's Jazz Company (Harrah's Jazz), an equal partnership consisting of Harrah's New Orleans Investment Company (an HET subsidiary), New Orleans Louisiana Development Corporation, and Grand Palais Casino, Inc. The Hemmeter group contributed its lease rights and certain other real estate interests in the vicinity of the Rivergate site while the HET group agreed to share ownership of the project with the Hemmeter group.

Negotiations began immediately with the City and the State relative to a new lease agreement (the Lease) and the Casino Operating Contract. The Lease was executed with the City in March, 1994 while the Casino Operating Contract was executed with the State in July, 1994. [In April, 1994, the State, in compliance with an Attorney General's ruling, had issued a third RFP. Harrah's Jazz re-submitted its proposal which was accepted by the State.]

Harrah's Jazz began operating a temporary casino in the Morris F. X. Jiff Auditorium in the City (the Temporary Casino) and constructing a new permanent casino facility on the site of the former Rivergate Convention Center in downtown New Orleans (the Permanent Casino). However, even as construction commenced, legal controversy arose concerning the planned removal of the Joan of Arc statue that stood in front of the soon to be demolished Rivergate Convention Center.

The Louisiana Landmarks Society successfully convinced Federal Judge A.J. McNamara to issue a temporary restraining order against disturbing the Place de France, the plaza where the statue stood. Construction plans called for the incorporation of this plaza into the new casino and the removal of the statue to an yet-to-be-determined location.

Less than seven months later (November 19, 1995) representatives of the Harrah's Jazz bank syndicate informed Harrah's Jazz that the bank syndicate would not disburse funds to Harrah's Jazz under the terms of Harrah's Jazz's $175 million bank credit facility (the Jazz Credit Facility). Faced with an absence of funding, on November 21, 1995, Harrah's Jazz decided to cease Temporary Casino operations and construction on the Permanent Casino, as well as to file for bankruptcy protection. Of the projected $30 million a month in revenue from the Temporary Casino operations, only about $13 million a month were actually realized. Furthermore, initial cost estimates for the Permanent Casino had soared to $850 million from an original $425 million estimate.

The Jazz Credit Facility was accelerated and terminated by the bank lenders on November 21, 1995. Thereafter, on November 22, 1995, Harrah's Jazz and its wholly-owned corporation, Harrah's Jazz Finance Corp., filed for reorganization under Chapter 11 of the Bankruptcy Code. As of that date Harrah's New Orleans Investment Company (an HET subsidiary) owned approximately 47% of Harrah's Jazz.

In connection with the November 1994 “closing” of Harrah's Jazz's Public Debt (i.e., 14.25% First Mortgage Notes--due 2001) and the Jazz Credit Facility, HET delivered completion guaranties to (1) the trustee under the Public Debt (under which the City was an express third-party beneficiary), (2) the bank lenders under the Jazz Credit Facility, and (3) the Louisiana Economic Development and Gaming Corporation (the state agency regulating Harrah's Jazz (LEDGC), now the Louisiana Gaming Control Board (LGCB)). Each completion guaranty was subject to certain conditions, exceptions and qualifications (see Art. XXVI, Casino Operating Contract). Respecting these guarantees, HET maintained that (a) the failure of Harrah's Jazz to obtain the funds under the Jazz Credit Facility and (b) the acceleration of the loan by the bank syndicate terminated HET's obligations under the completion guaranties.

At that time HET had made total capital contributions to the project of approximately $90 million and had outstanding advances to the project of approximately $25 million. In addition, in December 1995, HET acquired from a commercial bank a $16 million loan to a Harrah's Jazz partner in satisfaction of HET's obligations under a preexisting agreement with the bank. HET wrote off these investments and other related costs in the project. During fourth quarter 1995, HET recorded a one-time pre-tax charge of $75.5 million, representing HET's write-off of its remaining investment in Harrah's Jazz, its advances to Harrah's Jazz in its role as manager of the Temporary Casino, and other related costs.

On March 4, 1996, Harrah's Jazz entered into a preliminary agreement with the City which provided for, among other things, an immediate $4.3 million cash payment by Harrah's Jazz to the City, of which $2.5 million was funded by HET as debtor-in-possession financing and the balance was funded from Harrah's Jazz's assets. Although the $2.5 million loan was an administrative priority claim in the bankruptcy, there could be no assurance that the loan would be repaid. In exchange for these agreements by Harrah's Jazz, the City agreed to waive any requirements to reopen the Temporary Casino and to negotiate in good faith numerous specified issues relating to the lease of the Permanent Casino site.

On April 3, 1996 Harrah's Jazz filed its first reorganization plan (the Original Plan) for the land-based casino project with the federal bankruptcy court in New Orleans. The approximately 200 page plan and related disclosure statement addressed: how the debtor partnership would be restructured; revised payments and schedules for all creditors; lease and operating proposals for the City; and the proposed size and scope of the project for the State.

State Proposal. (A) Compensation: The Original Plan did not provide for any concessions regarding the State compensation provisions mandated by the Gaming Act. The casino operator will pay the State 25 percent of gross gaming revenues of the temporary casino during an approximately two year time frame while construction of a permanent casino progresses. At the time the permanent casino is completed, no later than December, 1998, the casino operator will pay compensation to the State in accordance with percentages currently contained in the Operating Contract (ranging from 19 percent to 25 percent) with a $100 million minimum in annual payments. *(B) Timing of Casino Construction and Opening:* Under a fast tracking development schedule, a temporary casino at the Rivergate site of approximately 56,000 square feet of net gaming space would be ready for use on or about January 1, 1997. A second phase of up to 42,000 square feet of net gaming space is to be completed by second quarter 1997, including special event, food service and meeting room space. The next step would be to jointly pursue with the City the development of the second floor of the facility which would be a non-gaming entertainment complex. A third phase of the casino would be completed during 1998 for a total of not less than 100,000 square feet of net gaming space. Depending on market conditions, gaming space could be increased to up to 130,000 square feet. *(C) Completion Guarantee and Other Issues:* HET would provide a new completion guarantee in connection with the Original Plan, which guarantee would not be subject to financing conditions upon confirmation of the Original Plan. The guarantee would be supported by mutually acceptable third party guarantees and/or collateral. In addition, as a part of an approved Original Plan, the parties would exchange mutual releases for all events and claims arising on or before confirmation of the Original Plan.

City Proposal. The Original Plan outlined resolution of terms for interim lease payments to the City for the temporary casino site by Harrah's Jazz and a waiver by the City of any requirement to reopen the temporary casino at Basin Street. The City and Harrah's Jazz agreed to cooperate in development of certain areas of the second floor of the permanent casino established as non-gaming areas, subject to state approval. The City and Harrah's Jazz agreed to negotiate in good faith on all specific issues related to the operation of the permanent casino and to eliminate conflict between city agreements and the state gaming act. The Original Plan also proposed changes in the Open Access plan (i.e., a minority hiring plan) which did not change the general intent of the program, but rather, modified and refined the program given the practical experience Harrah's Jazz had over the previous 12 months.

Bondholder Proposal. The Original Plan contemplated that bondholders would exchange their current $435 million of 14 1/4 percent (plus contingent interest) First Mortgage Notes due 2001 for $187.5 million of 8 percent Senior Subordinated Notes due 2006 with contingent payments based on a percentage of EBITDA and Senior Subordinated Contingent Notes due 2006 on which all payments would be contingent based on a percentage of EBITDA, and 50.1 percent of the equity of a publicly traded holding company of the new Harrah's Jazz.

Unsecured Creditors Proposal. The Original Plan contemplated establishing a cash allocation of $8.5 million which would be sufficient to pay presently known undisputed unsecured creditor claims in full. The Original Plan further contemplated the assumption of the two major construction contracts. It was anticipated that the payments necessary to cure default would be negotiated with the contractors. The plan also contemplated that unsecured claims of HET of up to $40 million be contributed as equity.

Harrah's Jazz Company Proposal. The Original Plan contemplated that the sponsors of the Original Plan would purchase 49.9 percent of the new holding company's equity for $75 million. HET had entered into discussions with its partners in Harrah's Jazz regarding this issue but agreed that it would fund the entire amount if NOLDC or Grand Palais did not participate. In addition, as part of the Original Plan, HET agreed to put up $12.5 million as debtor in possession financing (of which $2.5 million had already been funded and approximately $4.4 million was expected to be funded), which would be credited against the $75 million.

The Original Plan was neither approved by the creditors nor confirmed by the Bankruptcy Court. The Court, however, extended the “exclusivity” time period to present an acceptable reorganization plan. As a result Harrah’s Jazz entered into further negotiations with the interested parties: the City, the State, the secured creditors (i.e., the bondholders) and the unsecured creditors (i.e., the general contractor and others).

Further complicating matters, in April 1996 the Legislature passed H.B. 7 which required local option votes during November 1996, in all parishes, on the operation of gaming activities. As a consequence of this legislation long-term financing would be difficult, if not impossible, to arrange until after the vote. In light of the unknown impact of this legislation, Bankruptcy Judge T.M. Brahney III further extended the “exclusivity” time period till after the mandated vote. [The November 1996 vote in Orleans Parish supported the land-based casino project by a 2 to 1 margin.]

On October 14, 1996, Harrah's Jazz entered into a permanent lease agreement with the City which was approved by the Bankruptcy Court on October 16, 1996. In addition to various annual payments to the City, the Orleans Parish School Board, and the New Orleans Police Department, HET agreed to the following major lease terms:

- during the first 12 months of the casino's operation, 55 percent of its employees must be Orleans Parish residents. That minimum will rise by 2 percent each year until 65 percent of its workers live in Orleans Parish;
- contribute $1 million annually to a "destination marketing program" established by the City to promote New Orleans and the casino;
- guarantee completion of the casino;
- pay the City $1 million for expenses and legal fees associated with the bankruptcy proceedings;
- pay $200,000 for four studies monitoring the casino's effect on tourism, pathological gamblers, crime rate and real estate speculation.
- allocate to the City 50% of rent income generated from roughly 70,000 square feet of retail space to be located on the casino's second floor.

The City, meanwhile, agreed to:

- let Harrah's Jazz provide finger food to its high-rolling customers. But the gambling company must contract with a Louisiana restaurant to create the snacks;

- let Harrah's mount marquees on its exterior facade to advertise special events;
- Allow up to 5,000 square feet of the first floor of its gambling emporium for retail operations. Plans for the second floor will be finalized after a study that Harrah's will finance;
- allow removal of the Joan of Arc statue.

On February 28, 1997, the Bankruptcy Court approved the disclosure statement of Harrah's Jazz relating to the First Modified Plan and set a confirmation hearing to approve this for April 14, 1997. Under the First Modified Plan, the assets and business of Harrah's Jazz would vest in Jazz Casino Corporation, a newly formed corporation (JCC), on the effective date of the First Modified Plan. JCC would be responsible for completing construction of the Rivergate Casino. Under the First Modified Plan, existing public debt of Harrah's Jazz would be canceled and the holders of that debt would receive 37. 1 % of the equity in JCC's parent (JCC Holding). An additional 15% of the equity in JCC Holding would be allocated to debtholders who executed certain releases and HET would receive, in exchange for equity investments and other consideration to be provided under the First Modified Plan, the remaining 47.9% of the equity in JCC Holding, a portion of which would be assigned to certain Harrah's Jazz partner-related parties. In addition, holders of the public debt would receive (i) $187.5 million in aggregate principal amount of 8% Senior Subordinated Notes of JCC due 2006 with contingent payments, and (ii) a pro rata share of Senior Subordinated Contingent Notes of JCC due 2006.

In April 1997, the Bankruptcy Court confirmed the First Modified Plan. However, since the Legislature did not approve a key component of the First Modified Plan--a modified casino operating contract with the LGCB--this Plan, like the Original Plan, was not consummated. The stumbling block for the Legislature was the lack of a guarantee of the $100 million tax payment due the State.

Subsequently, Harrah's Jazz filed a Second Modified Plan with the Bankruptcy Court which contemplated, among other things, the assumption of the July 1994 casino operating contract and relief from payment of any gaming taxes under the casino operating contract. The demand for such tax relief was predicated on the fact that the State failed to enforce regulations requiring river boat gaming operators to actually cruise the river which effectively created other land-based casinos--a violation of Harrah’s Jazz’ monopoly rights under the July 1994 casino operating contract. Bankruptcy Judge T.M. Brahney III, however, expressed his reluctance to summarily waive tax payments to the State unless Harrah's Jazz could justify such relief. He asserted that, unless Harrah’s Jazz could prove differently, such matters were more properly the subject of a separate law suit, not the bankruptcy proceeding. As a result of this and certain other matters, the Second Modified Plan was withdrawn by Harrah's Jazz. (Harrah’s Entertainment, Inc., 1995, 1996, 1997)

During October 1997, Harrah's Jazz and HET attempted to gain concessions from the casino's bondholders (the project's most powerful creditor group) concerning their participation in the $100 million annual state casino tax guarantee, which Governor Foster demanded before he would support any reorganization plan. In the hope of forcing the bondholders to shoulder part of this guarantee, HET threatened to cut off further interim financing and to recommend liquidation of the project. The bondholders persisted in their refusal and talks broke down.

At that point U.S. Trustee Diana Rachal stepped in to help break the impasse by actually filing a motion to liquidate with the Bankruptcy Court. This motion, if approved by the Court, would have established a deadline for the parties to either agree on the casino project or face liquidation for cents on the dollar. This action spurred the parties to reach a compromise under which HET would

guarantee the $100 million tax payment in exchange for lower interest rates and other concessions from the bondholders. The motion to liquidate was continued and finally dismissed by Bankruptcy Judge T.M. Brahney III on June 16, 1998.

In November 1997 and again in January 1998, on the heels of the October compromise, Harrah's Jazz filed a third reorganization plan. This plan (i.e., the Third Modified Plan), which was supported by, among others, Governor M.J. "Mike" Foster and Mayor Marc Morial, contemplated that a newly formed limited liability company, Jazz Casino Company, L.L.C. (JCC), would be responsible for completing construction of the Rivergate Casino, HET would receive approximately 40% of the equity in JCC's parent, and Harrah's would make a $75 million equity investment in the project (less any debtor-in-possession financing provided to the project), guarantee JCC's $100 million annual payment under the casino operating contract to the LGCB (the "State Guarantee"), guarantee up to $154 million of a bank credit facility of up to $224 million, guarantee timely completion and opening of the Rivergate Casino and make an additional $10 million subordinated loan to JCC to finance the construction of the Rivergate Casino. With respect to the State Guarantee, HET would be obligated to guarantee the first year of JCC's operations and, if certain cash flow tests and other conditions were satisfied each year, to renew the guarantee each year for a maximum term of approximately five years. HET's obligations under the State Guarantee would be limited to a guarantee of the $100 million payment obligation of JCC for the period in which the State Guarantee is in effect and would be secured by a first priority lien on JCC's assets. JCC's payment obligation would be $100 million at the commencement of each 12-month period under the casino operating contract and would decline on a daily basis by 1/365 of $100 million as payments are made each day by JCC to the LGCB.

The Third Modified Plan was confirmed by the Bankruptcy Court on January 29, 1998. Final consummation of the plan was subject to numerous approvals, including approval from HET's Board of Directors, the Legislature, the City, and others. Although Governor Foster endorsed the Third Modified Plan, he refused to call the Legislature into a special January or February session to consider its approval. Rather, he preferred that the Legislature call itself into session. The Governor also took the position that the casino operating agreement could be approved by the special fiscal-only session of the Legislature in March 1998.

The Legislature, imbued with both antigambling sentiment and a distrust of HET, not only failed to call itself into a special session; but, at the 1998 March fiscal-only session, it also failed to approve the casino operating agreement. In response to the recalcitrant attitude, the Governor, concluding that LGCB could approve the casino operating agreement without the Legislature's consent, ratified the LGCB's actions, thereby, effectively bypassing the Legislature. Later that Spring (May 1998), the Louisiana Supreme Court upheld the LGCB's power to approve the casino operating agreement without Legislative consent. (Caywood, T., 1998)

Currently, the Louisiana State Police are completing background investigations of HET's New Orleans Casino employees. Once completed, construction may resume. A target date for completion of sometime in October 1998 appears reasonable. These background investigations not only check for criminal or ethical problems that would make casino employees or investors unfit to run a gambling hall; but also investigate the financial suitability of the casino developer. The LGCB is expected to hired an accounting firm to audit Harrah's Entertainment, Inc. as to its financial

suitability. The LGCB must hold a hearing to examine the State Police report. These investigations and hearing are the last major hurdles facing the dormant casino project.

HET Executive vice President and Chief Financial officer, Colin Reed, predicted that the investigations would be finished in late September and that the company would emerge from bankruptcy protection a month later. He also predicted that the casino would be open for business by the Fall 1999. (Yerton, S., 1998)

CASE ANALYSIS

Type of Proposed Casino. The opening of the Mirage in 1989 forever changed the perception of a casino and the expected amenities that a casino should offer. Casino operators realized that success required more than merely providing the opportunity to gamble. To succeed, they needed to provide a full variety of services ranging from rooms to beverages, to restaurants, to entertainment. Unfortunately, the City and State failed (or refused) to recognize this and insisted on a "gambling only" casino which would not compete with existing clubs, restaurants, and hotels.

The Bidding Process. Prior to 1992, the states which chose to implement casino gaming (with the exception of Nevada), generally permitted an unlimited number of licenses, but restricted the location of such casinos. In 1992, however, a new philosophy emerged which restricted both the number of licenses and their location. The New Orleans project launched this new licensing scheme.

The selection mechanism for both the New Orleans lease and the State casino operating contract utilized the RFP process. This procedure requires a government entity to first define the parameters of a project and then request bids. For example, Illinois and Indiana allocate a limited number of licenses to specific cities who subsequently issue RFPs and select the winning bids. Once a casino operator is selected by a city, the state must then approve the license. An alternative approach was used by the Province of Ontario. There, the Ontario Casino Board selected both the city and the casino operator. The designated city was permitted to select the specific site for the casino.

The initial problem with the New Orleans casino project was that both the City and the State wanted the final say in the licensing process. The ensuing two-year political battle between the City and the State led to a shotgun marriage between three reluctant suitors.

The first salvo in this battle occurred in April 1992 when Mayor Sidney Barthelemy, facing major budget problems, issued an RFP for a casino to be located at the Rivergate site in downtown New Orleans. He took this action prior to the State actually legalizing gaming. The Mayor chose the Hemmeter group to negotiate a lease. This choice was subsequently approved by the city council. Meanwhile, in June 1992, the Legislature, by a one vote margin, finally authorized a single land-based casino at the Rivergate site. Shortly after this vote, the State requested that the City not sign a lease until the State chose a casino operator. The City ignored this request and entered into a lease with the Hemmeter group in April 1993. The State, however, refused to confirm the Hemmeter group as the casino operator and issued its own RFP on April 29, 1993.

On August 11, 1993, the State selected the Harrah's group to operate the New Orleans land-based casino. The ensuing stalemate between the Hemmeter group, the City's choice, and the Harrah's group, the State's choice, was successfully mediated by then-Governor Edwards, a staunch gaming proponent. The result of this effort was Harrah's Jazz which entered into new negotiations

with both the City and the State. These negotiations led to a new lease with the City in March 1994 and a Casino Operating Contract with the State in July 1994.

Temporary Casino. Two years had now passed. The City and State, needing revenues, felt that they could not wait another 15 months for the Rivergate facility to open. Thus, an agreement was reached to open a temporary casino at the Municipal Auditorium which would cost $41 million to renovate. This temporary casino opened on May 1, 1995, four months later than originally planned. It was situated east of the French Quarter in an economically depressed, high-crime area, far from major hotels and restaurants. Access to this casino was limited to taxies and autos. Amazingly, City officials encouraged patrons not to travel by foot or to park outside of the designated parking facilities offered by the temporary casino. While there is no direct evidence that this was one of the reasons that the expected casino visitations did not meet projections, one can not dismiss the old adage that location, location, location is the key to success in any business. In addition, the Mississippi River flooded that spring causing a temporary shutdown.

Permanent Casino. The permanent casino site is situated at the end of Canal Street between the New Orleans French Quarter and the 10,000 room hotel district. It is also within walking distance of most major downtown attractions.

The Hemmeter group's original proposal was to demolish the Rivergate convention facility and build a new facility. The Harrah's group, on the other hand, proposed remodeling the convention facility in three phases, 40,000 sq.ft. at a time. Ultimately the Hemmeter group plan prevailed and a new structure was started.

Financial Constraints. Financial constraints for the New Orleans project should be viewed from two perspectives:

- restrictions placed on the casino operations, and
- additional expenses placed on the casino.

A modern casino needs to be a full service operation which includes providing its cliental not only with the opportunity to gamble, but also with quality food, beverages, lodging, and entertainment. The City did not want the casino to take business away from existing New Orleans food, beverage and lodging establishments; and therefore, issued a RFP that either totally proscribed such amenities or limited them to a few, low quality facilities.

Astonishingly, the RFP indicated that the City believed that a potential casino operator would be more than happy to provide additional funds to the city as a bonus incentive for the lease. The RFP stated: "The casino development potential is so significant and valuable to the proposers, that the City encourages proposers to provide monetary benefits or bonus items to the City. These long term economic benefits to the City that may be achieved by a combination of factors, such as:

- Contributions-in-aid in the form of facilities or services to the City and/or not-for-profit agencies;
- Specific commitment for other real estate development within the City limits;
- Ground lease participation rent based on percentage of gross revenues, over and above the "win tax" payable to the state."

These additional "bonus" expenditures, when coupled with sizeable shortfalls in temporary casino revenues ($13 million a month instead of $30 million a month), a required minimum annual State gaming tax of $100 million, sky-rocketing construction costs, and regular lease payments, doomed the project.

Competition. Both the City and the State believed that the New Orleans project's monopoly feature created a significantly more favorable gaming climate for the New Orleans casino operator than that faced by its Atlantic City counterparts. While belief is admirable, its reality that wins out. First the New Orleans population base more closely resembled Las Vegas than Atlantic City. Less than 11 million people live within 300 miles of New Orleans whereas the New Jersey market has a population base of 60 million.

Furthermore, the New Orleans project did not share the non-competitive Atlantic City environment. By the time the temporary casino was fully operational in 1995, six river boat casinos were plying the New Orleans waterfront. Up to 15 other river boats were slated to cruise from other Louisiana cities. In addition, Biloxi, Mississippi (less than 60 miles away) had opened major casinos. Other casinos were also scheduled to open at various sites along the Mississippi side of the River. Furthermore, the State had authorized up to three slot machines (i.e., video lottery terminals) each for bars, taverns, restaurants, and clubs. Thus, thousands of convenient limited gaming locations were now available throughout the state effectively eliminating the need for the casual gambler to travel to New Orleans.

Financial Viability. As Harrah's Jazz reached agreement with both the City and the State, the casino project costs had escalated from $425 million to $850 million. Harrah's Jazz' equity contributions amounted to only $170 million, 20% of the total project costs. Thus, the remainder of the required funding had to come from bank financing ($138 million), a junk bond offering ($435 million), and forecasted cash flows from the temporary casino ($72 million). This debt/equity ratio proved fatal in the face of sever revenue shortfalls.

More importantly, however, City and State officials, more concerned with collecting revenues than insuring a financially viable enterprise, failed to appreciate the nuances associated with the newly created joint venture (Harrah's Jazz). First, it was a shotgun marriage from its inception. Secondly, their monetary demands were based primarily on the financial stability of HET, which had neither given guarantees nor provided evidence that it would continue funding Harrah' Jazz in the event of continuing cost over runs or other financial difficulties.

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IN SEARCH OF EXCELLENCE ON THE INTERNET: DELL COMPUTER CORPORATION'S DIRECT MARKETING STRATEGY

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CASE DESCRIPTION

The primary subject matter of this case concerns the highly successful direct marketing strategy of Dell Computer Corporation. Secondary issues examined include the use of the internet by students to access information about corporations. The case is appropriate for the junior level or graduate introductory marketing course and the senior level or graduate strategic management or strategic marketing courses. The case is designed to be taught in one class hour or may be used as an example of an internet exercise that could take two to five hours to complete.

CASE SYNOPSIS

This case illustrates the type of information that can be found by students assigned to use the internet to find an example of excellence in the selection and implementation of a strategy. The success of Dell Computer Corporation's direct marketing strategy is discussed along with its strengths, weaknesses, opportunities and strengths.

THE ASSIGNMENT

Derek pondered with his fellow team members the latest assignment for their strategic management class. The professor wanted each team to find and write about an example of excellence in the selection and implementation of a strategy. The professor also requested that the students use the internet as their primary instrument of research. Derek had recently purchased a Dell Computer on the internet and had found quite a lot of information about the corporation from its web pages. (WWW.DELL.COM/) Francisco suggested that they could also find out a lot about Dell from articles found by an ABI Inform search of 800 journals and periodicals on GALILEO (WWW.GALILEO.PEACHNET.EDU/HOMEPAGE.CGI), the Georgia Library Learning Online system available to students of the University System of Georgia. The following is distilled from the 1,300+ references about Dell that they found on the internet.

INTRODUCTION

Dell Computer Corporation, the fastest growing company in its industry, and the leader in direct sales, was founded 1984 in Austin, Texas. It has been almost 14 years since Dell pioneered the concept of selling personal computer systems to customers; offering built-to-order computer systems; and providing direct, toll-free technical support and next-day, on-site service. The company designs and customizes products and services to end-user requirements, and offers an extensive selection of peripherals and software.

Dell is the pioneer and leader of the customer-direct, build-to-order computer systems business. Because customers are central to Dell's business, the company provides personalized services, outstanding price/performance in its products and is fast to market with the latest relevant technology. By exploiting Internet commerce and technology, offering new value-added services and expanding its global reach. Dell is evolving the scope and efficiency of its direct business model to unprecedented levels.

Dell designs, develops, manufactures, markets, services, and supports a complete line of personal computers compatible with industry standards. Dell is the world's leading direct marketer of personal computers and one of the top five personal computer vendors in the world. Its direct sales approach eliminates layers of middlemen by dealing with customers directly. It also reduces inventory costs by custom-making machines to customer specifications. That means the company carries no obsolete parts and can deliver both the newest technology as soon as it become available plus if any reductions in component costs are passed immediately on to the customer. These gave Dell an estimated price advantage of 15% over rivals who sell through distributors. The Dell's becomes the synonymous with the latest in technology at the keenest prices and backed up by superior after-Sales Service.

Today, Dell Computer Corporation is the world's leading direct marketer of personal computers. The company is organized into three core geographical business units: Dell Americas, Dell Europe, and Dell Asia Pacific. It has direct sales operations in 33 countries and customers in more than 160 countries. Manufacturing facilities are located in Austin, Texas; Limerick, Ireland; Penang, Malaysia; and Xiamen, China. Each of these core geographical areas has Dell sales, engineering, support, and service personnel to manage government, corporate, and multinational accounts. The Dell Direct-Sales model and broad-scale geographic representation allows better management of customer requirements on a global basis and provides consistency of product. Dell's global commitment is one of the best in the industry. Dell offers comprehensive, focused service, support, and asset management programs around the world in an effort to help customer reduce overall costs of the ownership (Dell Computer Corporation, 1998).

BACKGROUND

Michael Dell began his computer business at the University of Texas, Austin. His dorm-room business officially became Dell Computer Corporation in 1984. Two years later, Dell Computer grew to 250 employees, and the company introduced the 2866-12 machine, which PC Week said, "…may become next industry benchmark."

In 1987, the company opened an office in the United Kingdom. This was the first step for the company doing business globally. Within the following 10 years, Dell opens offices in 33 countries. In that year, Dell's incoming call rate reached almost 1,700 per day. Dell's initial public offering was completed in June 1988. The company's common stock trades on the Nasdaq National Market System under the symbol DELL. The company employed 650 people and has record sales of $159 million.

Dell became the first PC manufacturer to offer free installation of applications software as a standard service option in 1991. In 1992, Dell introduced a new product line of low-priced Dimension PCs, which is one of the most highly decorated systems in the industry, winning many awards. In 1993, Dell joined ranks of the top-five PC makers worldwide Subsidiaries in Australia and Japan are company's first entries into Asia-Pacific region. In 1996, Asia-Pacific manufacturing center in Penang, Malaysia, opened customers begin buying Dell computers via Internet, and begins major push into network-server market. In 1998, Dell sales via Internet exceed $4 million per day; Dell announces major expansion of European manufacturing center in Limerick, Ireland; to keep up with demand in China, Dell announced the building of a China Customer Center in Xiamen (Dell Computer Corporation, 1998).

CORPORATE ANALYSIS

It has been almost 14 years since Michael Dell pioneered the concept of selling individually-configured PCs directly to customers, and distribution strategy is still considered by Dell Computer to be at the heart of its outstanding performance. "Direct" is how the company describes its relationships with its customers, from home-PC users to the world's largest corporations. There are no retailers or other resellers adding time and cost to the distribution of its products to customers, or interfering in Dell's understanding of customer expectations. By selling computers directly to its customers, Dell achieves several advantages over its retail competition: (1) Price for performance—by eliminating resellers, retailers, and other costly intermediary steps, coupled with an efficient procurement, manufacturing, and distribution process, Dell is able to offer its customers computer systems with more power and versatility for the money than its competitors. (2) Customization—Dell builds every system to specifications chosen by each individual consumer. Customers get exactly, and only, what they want. (3) Service and support—by collecting and maintaining information gained from direct contact with customers before and after the sale, Dell is able to provide responsive, tailored customer service and technical support. (4) Minimal inventory—computer systems have an extremely rapid "spoilage" rate, meaning that purchased components quickly become worth less than they were bought for, and that manufactured systems lose their value rapidly. With its direct method, Dell can minimize its components inventory as well as the time-to-customer of its manufactured systems, thereby substantially reducing costs. Inventory is turned over every 10 days. (5) Latest technology—Dell's direct model ensures that the latest relevant technology is introduced into its product lines much more quickly than the slower-moving indirect distribution channels allow.

Customer orders at Dell progress through three phases: pre-sales activity, manufacturing, and delivery and installation of the computer system. For new customers who are uncertain of their computer needs, Dell's sales force provides advice and configuration planning through its toll-free

telephone number. The order is placed over the telephone or on the company's Internet site, and then verified and sent to one of its manufacturing facilities.

When the order arrives, it is built and configured in a controlled assembly process using automated software download systems and multiple automatic diagnostic test functions. Numerous and rigorous quality checks are performed throughout the computer manufacturing process. All system components, including memory, video circuits, and drives are tested to assure they are functional and match the customer's order.

Once this process is completed, the computer is ready for packing and shipping. A final check is dome to ensure that all components ordered by the customer are included in the product. The computer is then carefully packed in specially-designed protective cartons so that it arrives undamaged, and is shipped by FedEx directly to the customer. Since the computer ships with all ordered software factory-loaded, it requires minimal installation by the customer. However, if a customer has questions or problems with an order, Dell operates a 14-hour, 6-day toll-free technical support hotline that is ready to assist customers for the life of the product (Dell Computer Corporation, 1998).

Dell's direct model was challenged by a skeptical Jim McDonnell, Hewlett-Packard's marketing boss for PCs, who insisted that Dell could not deliver a custom-built computer to a customer in under a week (Kirkpatrick, 1998). David Kirkpatrick of *Fortune* logged on to Dell's Internet site on the night of April 17, 1998, and ordered a state-of-the-art system to be sent to his home. The fully assembled and tested machine arrived 5 days later, in the afternoon of April 22.

STRENGTHS

Dell combines its finely tuned direct model with other company strengths. The company's systems perpetually receive superior performance ratings from the major independent computer magazines' performance benchmarks and consumer response surveys, most often taking the number one or number two ranking overall among home as well as business computers. This high level of performance is maintained in part by a $250 million annual research and development budget (Briody, 1998).

Dell's strengths have lead to phenomenal growth rates in sales, earnings per share, and stock price. Dell's annual sales growth rate is over 60%, and is not expected to slow in the foreseeable future. Furthermore, in just the past five years, Dell's stock price has risen from below a multiple-split-adjusted $1 per share to over $80 a share. In the last year alone Dell's stock price has risen by over 200%. To put that in perspective, a $1000 investment in Dell in 1996 would be worth over $20,000 today.

WEAKNESSES

A substantial weakness of Dell's direct model is that it tends to exclude first-time and less technologically savvy computer buyers. The company makes no secret of the fact that its distribution strategy is targeted primarily towards second-system and technologically-minded consumers, and contends that market is the most lucrative place to be. Most first-time and new-user buyers shop for computers at retail outlets like Circuit City, where they can speak face-to-face with a salesperson, and

actually touch and practice using a computer. To put together a customized system takes some degree of knowledge about computer systems, and a belief that once it arrives, the customer will be able to assemble it alone. In its ads, Dell puts together sample system packages in an attempt to take away some of the anxiety about shopping for a computer, but it is not the same as having a system in a store.

Dell's competition includes companies selling computers through direct and indirect distribution channels. The main competitor in the direct distribution business is Gateway. Other companies have also gotten into direct distribution after seeing Dell's success, including Compaq and CompUSA. Competitors who use a retail distribution channel include IBM, Compaq and Packard Bell. Dell has approximately 6 percent of the world market behind Digital/Compaq and IBM. Since 1997, Dell's US market share has also grown rapidly from close to 1% to almost 9% (Serwer, 1997).

OPPORTUNITIES

Technology continues to become increasingly embedded in our culture, and its rapid advancement has allowed the technology sector to continue this unprecedented growth stage of the market (some might even argue the market is still in its introduction stage). With a distribution method that appeals to the increasingly technophilic as well as cost-sensitive consumer, Dell is poised to continue to exceed the best efforts of its competitors.

America's computer giants are going global. Dell is already established internationally with plants and sales offices covering Europe, Africa, Asia, and most of the American continent. Dell manufactures its entire line of computers in its locations in Austin for the US and neighboring countries, Limerick, Ireland, for Europe, Middle East and Africa, and Penang, Malaysia, for Asia-Pacific and Japan. Even though Dell already has an international presence, there is still great potential for growth. According to Michael Dell, about 3 or 4 percent of the world's population owns a personal computer. This provides huge growth potential for the industry.

The Internet is also expanding at an astounding rate. Dell receives approximately 800,000 visits a day to its web site and uses it to sell more than $4 million worth of products and services every day. As the Internet is becoming more accessible to many people around the world, Dell's opportunities for growth increase.

THREATS

In an industry moving at the speed of electrons, threats to companies' survival continually plague even the largest of computer giants: (1) Rapid changes in technology have been a constant battle since the industry's inception. No other industry in the history of the world has advanced so rapidly as computers and computer technology. Computer companies don't know what standards will be accepted or rejected by consumers, or even what technologies they will be incorporating into their systems 6 months from now. This presents a huge challenge for a company whose order turnaround is under 1 week. (2) The economic crisis in the Pacific Rim, popularly referred to as the Asian Flu, has brought concern from investors and corporate analysts alike. Currency fluctuations can have drastic effects on an industry whose components are manufactured all over the globe. (3) Computer prices continue to fall. The "sub-$1000 PC" is bantered around the press and Wall Street

analysts. Dell contends that these machines are merely inventory dumpings by companies who still use indirect distribution methods and so suffer under massive inventory pressures. But the decrease in even high-end computer prices is also noticeable. (4) Most computer manufacturers that have traditionally used indirect distribution channels to deliver their products to customers have started using direct distribution to compete with Dell. Though none have thus far achieved Dell's expertise in the method, Dell has much to fear as those companies improve their system. (5) Dell is also faced with competition that uses indirect distribution methods to get products to customers. Some of these competitors use better advertising campaigns that may in the long run benefit them against Dell. (5) Finally, the computer industry is currently faced with potential governmental regulation. Microsoft is engaged in a legal battle with the Justice Department over allegations of anti-competitive behavior. The outcome of this lawsuit will have a direct effect on Dell due to the close relationship the Company has with Microsoft and its products.

INDUSTRY OUTLOOK

While the personal-computing market has expanded dramatically since the 1970s, Dell believes that the industry's best days and its own are yet to come, for two broad reasons: First, the stream of software and hardware innovation from companies such as Microsoft Corp. and Intel Corp. is rapid and robust, and is sharply increasing system performance and reducing the relative cost of computing. For example, in February 1982, Intel introduced its 286 chip, which was capable of processing 2.66 million instructions per second, or MIPS, at a clock speed of 12 million cycles per second, or megahertz. Today's Intel Pentium II processors are capable of more than 500 MIPS at 300 megahertz, and the sharp upward development trend is expected to continue. Second, while computer performance is going up, the relative cost of computing computer prices per MIPS has steadily declined, encouraging new computer users and more rapid PC replacement. Customers, in turn, are using those savings to buy even more powerful, more richly configured systems. As processor transitions and expected cost reductions continue, many industry analysts foresee worldwide industry volume growth of 15 to 20 percent annually over the next decade.

DEVELOPMENT OF THE DIRECT MODEL

Dell is continuously refining its direct approach to manufacturing, selling and servicing personal-computing systems. The company is committed to extending the advantages inherent in what is already the industry's most efficient business model. Current Dell initiatives include moving even greater volumes of product sales, service and support to the Internet, and further expanding an already broad range of value-added services. The Internet, the purest and most efficient form of the direct model, provides greater convenience and efficiency to customers and, in turn, to Dell.

Kevin Rollins, Dell's head of corporate strategy, says that his company is eager to extend its Internet business as far as possible. "Our vision is to have all customers conduct all transactions on the internet, globally," he says. It'll be a while before this happens--large corporate customers, which deliver 35% of Dell's revenues, are not yet buying over the Internet (although they most likely will be by year-end), nor are European or Asian customers. Dell services are focused on enhancing

computing solutions for, and simplifying the system buying decisions of, current and potential customers.

By taking its direct business model to even higher levels, through the Internet and value-added services, Dell intends to continue to grow its business at a multiple of the high-growth rate anticipated for the computer-systems industry as a whole. Dell still has significant opportunity for expansion in all parts of the world, especially in markets outside of the U.S.; in all customer segments; and in all product categories, ranging from home PCs to enterprise products, such as network servers and workstations.

RECOMMENDATIONS

Because of Dell’s direct business model, Dell has the flexibility to meet the future head-on. When the future arrives, Dell will be ready for it—no lag time will be required. From incorporating new technology into it’s machines to finding unique business opportunities, Dell will be on top of things. Since Dell sells directly to end users—and build every machine to order—it can easily drop the latest technology into place, be it the new Pentium® processor with MMX™ technology or special, long-lasting batteries for our notebook computers. This is a lot quicker than waiting for an inventory of old models to sell out first (and a lot more entertaining). Dell won’t just meet the future by bragging about advances in its product technology, it will also use new technology in the service part of its business. Dell has always prided itself on the service and support offered to its consumers, particularly in the way that it has been able to establish personalized relationships with the people who buy machines from them—individuals and multinational corporations. One of their principal benefits has always been that they have been a single point of contact for service and technical support.

Taking practical advantage of what the Net lets them do can only further our relationship with our customers (and save on 800 calls from Djibouti). The Online Store enables users to check out exactly what is available and purchase it, right from their homes or offices. Further, they can check on the status of their order at any time. In addition, since Dell is always looking for a better way to do things, they should continue to adapt to use new technology to further customize their services.

Of course Dell is already working on some jazzy new technology (jazzy as only micro-chips can be). But their goal should be just to have the newest features, but the right features. For example, in designing their notebook computers they did their best to combine the hot features, such as speed and memory size, into a unit that people can actually take with them and use without needing to plug it in every five minutes.

Dell is also involved in a couple of exciting new initiatives that could profoundly affect its future. Dell is a key member of the NetPC Consortium, a broad industry effort to make PCs more manageable and lower the total cost of ownership. The NetPC is designed to address the total cost of ownership for a user group that doesn't require the flexibility and expandability of the traditional PC. NetPCs are one element of Dell’s Managed PC offering. Dell's OptiPlex series of managed PCs reduces the total cost of ownership across all areas of IT management and the computing lifecycle as a whole.

Dell is excited that these and other initiatives will enable us to deliver one of the lowest total costs of computer ownership through its direct business model, products, personalized services and industry alliances. So, over-all, Dell’s goal shouldn’t be to give Buck Rogers a run for his money. but

to use technology to improve on what they do in selling computers and servers or offering technical support to people using them.

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SHOEMAKER STIMULATION SERVICES, INC.

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CASE DESCRIPTION

This case is concerned with a small oil services business located in West Texas. Strategic decisions must be made whether to sell the business, expand the business or to keep the status quo. This case should be appropriate for a small business or entrepreneurship course as well as strategic management.

CASE SYNOPSIS

This case chronicles the ten year history of a small oil services business from startup until the present. Discussed are problems relating to finance, marketing, and staffing. Students are asked to make strategic decisions about whether to sell the business, expand the business, or maintain the status quo.

INTRODUCTION

Larry Shoemaker, President of Shoemaker Stimulation Service, Inc.(SSSI), is sixty-eight years old and fast approaching retirement. He is currently looking into future plans for his company. Larry has 46 years of experience in the oil well servicing industry. SSSI services oil wells with acid and sand to help them produce oil or gas more efficiently. This service is performed with eighteen wheel trucks equipped with pumps that pump acid or sand down oil wells, in hopes of dislodging unwanted sediments from clogged perforations in the pipe that flow oil or gas. SSSI services wells within a 100 mile radius of Albany, Texas. Financially, SSSI has never had a loss since its inception in 1986. The past four years SSSI has averaged $500,000 in net sales, and sales are expected to increase in the future due to more oil wells being serviced in the industry.

HISTORY

In 1986, Larry Shoemaker retired from Halliburton, the largest servicing company in the area, after a 35 year career as the assistant district superintendent. After three months, he was bored and missed work. Larry had also heard that some of Halliburton’s employees were dissatisfied with their jobs, and wanted new employment. With these things in mind, Larry decided to go into business for

himself. In the process of starting his company, he hired six Halliburton employees as field workers. One of the employees, Paul Potter, was named Vice President. Paul had a great influence on the startup of the business, by helping Larry acquire trucks and equipment before they started the actual company. Larry and Paul started spreading the word to let oil well owners know that they were going to be available to do business.

ECONOMIC FORCES

The key economic force that helps drive the oil service industry is the oil imports we receive from foreign countries, particularly the middle east. If the United States imports more oil than it exports, the price of oil tends to go down. Thus, oil firms sell less oil, which decreases oil production and fewer servicing jobs will be performed. However, there is a period of time that can be very lucrative for the service industry during this time. For instance, when fewer wells are being drilled, there tends to be a slight increase in servicing the existing wells that are already in production. Larry says oil prices rarely affect his business. He is confident that he is in a safe industry to keep steady flows in revenue.

Another factor that affects servicing companies profits is volatile chemical prices. Larry says that chemical prices such as acid are constantly on the rise, increasing usually twice a year. As prices continue to increase, it becomes more difficult for companies to manage expenses.

Government taxation laws are another important economic factor that affects the oil well service industry. These taxation laws that face corporations are continually changing. It is very important for small companies to learn the tax advantages that are available. For instance, corporations can purchase preferred stock from other corporations and get a 80% tax break. This provides an excellent means of increasing cash reserves within retained earnings, while still keeping the cash liquid for any future purchases that might arise. Currently, SSSI has an estimated $180,000 cash from retained earnings that is in a checking account at the local bank.

COMPETITIVE FORCES

SSSI currently has competition in the surrounding area. The largest competitor is Halliburton located in Abilene, Texas. They have about fifty employees, along with four acid trucks and two frac(sand) trucks. Halliburton's main business is cementing, which is the process of pouring cement around the outside of the underground pipe to hold the pipe into place. The cementing business is a very profitable business and many well servicing companies have expanded into this area. Halliburton also does acid and frac(sand) jobs on the side. Due to Halliburton's pricing policies, the smaller companies in the area can beat them on price. Currently, Halliburton's markup is very high, thus, small companies in the area can beat Halliburton's prices on a servicing job by an average of 30%. One year after SSSI went into business, Halliburton decided to close its Albany office and move its trucks and equipment to Abilene, its main headquarters in the area. Halliburton does most of the large acid and sand jobs, which the smaller companies cannot perform due to lack of equipment. Larry expects Halliburton to move out of Abilene in the next few years, due to the low revenue producing area. SSSI is one of four small companies that compete for jobs in the local area. This keeps SSSI and the others so busy that they usually turn down jobs due to a lack of trucks, equipment, and

employees. SSSI currently turns down on average seven jobs per month. The shortage of equipment forces well owners to use Halliburton when the other smaller companies have their eighteen wheel pump trucks out on location. However, Larry is hesitant to expand his company because he feels that there is not enough demand to justify the purchase of another truck. Another reason to not expand is that he is ready to retire and expanding his business would mean added time to his work day. Also, Larry feels that there are not enough good workers in the area that are willing to learn how to run the trucks and be safe. A good used truck can be purchased for about $180,000. The average oil well servicing job is priced at $2,500, with a range in price varying from $500 to $7,000. Prices are dependent on the depth of the oil well and the amount of chemicals the oil well driller requests.

GOVERNMENT REGULATION IN THE SERVICE INDUSTRY

There are several factors that threaten companies competing in the oil well servicing industry. First, companies such as SSSI uses hazardous chemicals to treat wells, which brings about tight rules and regulations from government agencies. The Occupational Safety and Health Administration (OSHA) regulates industry equipment and the safety of the work environment. OSHA can fine a company for any breach of regulation that pertain to a safe work environment. OSHA also regulates hazardous materials and the way they are handled. For instance, if a company spills a large amount of acid, they can be forced to dig up the dirt around the spill and ship it to Austin, Texas to be evaluated. The company that spills chemicals has to pay the cost of shipping new dirt to take the ruins' place.

The Department of Transportation(DOT) also plays an important part in the environment in which the oil well service industry operates. DOT can evaluate eighteen wheel trucks to see that they meet safety criteria for road travel. As a result, companies in the industry can be fined for not following the rules and regulations of the DOT. Thus, employees must be highly trained to run the pump trucks correctly, and must be well versed in DOT rules and regulations.

Another environmental concern for SSSI is the worker's compensation insurance inspectors. These inspectors investigate the safety of the work environment at SSSI every two or three months. Failure to comply with their regulations can result in a loss of worker's compensation insurance that allows workers to draw compensation for being hurt on the job.

MANAGEMENT

Larry and Paul are owners of the company, with ownership interest of 85% and 15% respectively. Joyce is the secretary, in charge of keeping records of each job performed and answering the phone during regular office hours, 7a.m. to 4:30p.m. Monday through Friday. SSSI has calls after hours transferred to an answering services. SSSI currently has no computer to track invoices, inventories, and other budgets. The rest of the employees are field workers, who perform the servicing jobs.

Exhibit 1 shows the organizational chart for SSSI.

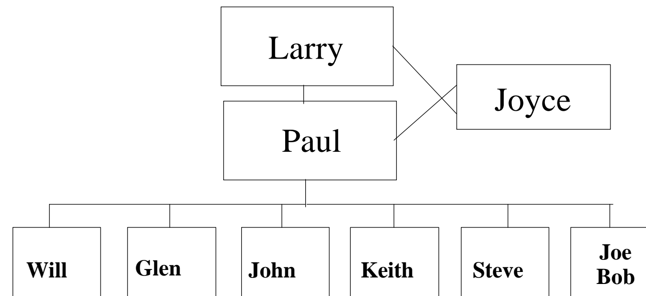

Exhibit 1

The culture of SSSI is very laid back. SSSI's field workers come in and talk to Larry on a social basis when there are no scheduled jobs. Also, the workers are good friends and have worked together since their Halliburton days. This produces an atmosphere that is good for communication between all employees. Managerial decisions can be quickly passed down the line of employees at SSSI.

Larry is in charge of all production/operations decisions. He directly communicates to the field workers servicing job criteria. Larry and Paul take turns working weekends. If a job must be performed on the weekend, then whoever is on call performs the job. The field workers are on a similar weekend schedule, with two field workers always on call for weekend jobs.

Jobs in the industry are obtained by bids. Customers call on the phone and Larry calculates the price for them. If a customer wants the job done, Larry tells the field workers directions to the well and the criteria in which to perform the job. Usually the owner of the well is at the well location during the service job.

SSSI currently has two eighteen wheel pump trucks, one having the capacity to hold 1,000 gallons of chemical mixture, while the other capable of holding 1,500 gallons of mixture. Whenever SSSI gets more than two jobs at the same time, they have to turn down the job. Larry says its not as bad as it sounds because they can perform four jobs with the two trucks in a days work, performing two jobs in the morning and two in the afternoon. SSSI has a sand truck which can haul up to 25,000 pounds of sand, and various other transport trailers and accessories. (SSSI also has a contract diesel mechanic that is on call in case a truck breaks down.)

SSSI also has a 5,000 square foot office building, a 3,000 square foot equipment shop, and a 1,000 square foot storage building for sand and chemicals all on a six acres lot northeast of town. The field workers sometimes use the equipment shop for personal uses.

MARKETING

SSSI advertises in the yellow pages of the phone book, high school football and basketball programs, church bulletins, and The Albany News. SSSI also purchases five one minute radio ads during broadcasts of local high school sporting events. There is no specific budget SSSI follows pertaining to advertising.

Larry visions SSSI as a means of helping the community that he lives in by supporting local commerce. SSSI has also brought new jobs to the community of Albany. He feels that helping the community is his duty. Larry says:

"Albany is my home. Everything that happens around here is everyone's business. Helping people is a way of life for the people of Albany. I simple do my part in helping Albany be a great place to raise a family for hardworking people."

FINANCE/ACCOUNTING

SSSI outsources its finance/accounting needs to a local CPA who provides Statements of Income and Balance Sheets each month. Exhibit 2 displays SSSI financial data for the past three years.

Exhibit 2

Income Statement from SSSI

	1994	1995	1996
Sales	$548,460.26	$501,569.21	$593,525.70
Total Expenses	$458,891.86	$462,107.21	$536,295.71
Net Profit	$ 89,568.40	$ 39,462.00	$57,299.99

Balance Sheet for SSSI

	1994	1995	1996
ASSETS			
Cash	$64,863	$58,356	$64,752
Accounts Receivable	$77,324	$71,225	$94,757
Inventory	$11,092	$18,375	$18,375
Total Current Assets	$153,298	$147,957	$172,756
Truck	$120	$120	$36,396
Equipment	$5,600	$2,368	$9,707
Pickups	$25,880	$20,178	$33,048
Building and Land	$70,519	$67,929	$65,339
Total Fixed Assets	$102,119	$90,595	$144,490
Total Other Assets	$18,871	$1,180	$1,180
TOTAL ASSETS	$274,287	$239,731	$318,426
LIABILITIES			
Total Current Liabilities	$19,342	$12,897	$20,563
Total LT Liabilities	$42,876	$26,643	$67,521
TOTAL LIABILITIES	$62,218	$39,540	$88,084

Retained Earnings	$125,977	$166,676	$180,370
Capital Stock	$1,000	$1,000	$1,000
Bonus Payable	($2,597)	($6,947)	($5,258)
Net Profit	$89,670	$39,462	$54,300
TOTAL EQUITY	$214,050	$200,191	$230,342
TOTAL LIABILITIES &OE	$276,268	$239,731	$318,426

SSSI has very good credit with the surrounding banks in town, due to Larry's community involvement and his commitment to debt management:

"My business has very little debt and that is the way it will stay. If I have the money to buy something, I will buy it, if not, I will probably pass it up. Debt to me is to used only in an emergency."

From following the guidance of Larry, SSSI has established itself as the premier servicing business in the area. Larry has more experience in the servicing industry than any other competitor. Well drillers from around the area call Larry on a regular basis and seek his professional advice on how to treat wells. Ask anyone in the industry, customer or competitor, and you will hear comments about how smart and experienced Larry Shoemaker is and how important he is the oil well servicing industry in West Texas.

THE FUTURE

The questions that concern Larry most are should he continue on working as president of SSSI, pursue a product development strategy by concentric diversification through cementing jobs, or just retire and maintain his ownership interest in the business? Another alternative might be to expand by picking up a new eighteen wheel pump truck to service jobs that are currently being turned down due to SSSI's lack of equipment and manpower. A plan of action needs to be developed for the near future.

TRANSFORMATION MANAGEMENT AT CSA, INC.

Michelle Talor, Florida Tech
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CASE DESCRIPTION

The primary subject matter of this case concerns management of change. The case has a difficulty level of level four. The case could be discussed in a one-hour class meeting, and is expected to require up to two hours of outside preparation by the student.

CASE SYNOPSIS

Late in 1995, several senior managers recognized that several critical issues had surfaced and began calling for change. External pressures, such as changes in markets, government priorities and budget allocations, increases in competition, and competition for good employees were some of the critical issues facing the company. Although CSA had experienced 30 years of growth, it was recognized that growth was no longer guaranteed if the company did not change, especially in light of rapidly changing conditions.

BACKGROUND

CSA, Inc. (* actual name withheld, permission to use name was denied) was founded in 1966 with a single purpose; to solve the most demanding current technical problems. The company established itself as a technological innovator by working for the United States government and providing modeling, simulation, analysis and evaluation of integrated navigation and guidance systems for such high profile programs as the Minuteman Missile and the Space Shuttle. This work led to the firm's technically renowned reputation in the areas of geodesy, radio navigation, radar, sonar, mapping science, and optical systems. In the 1970s, its efforts spread into the areas of information management and decision-support systems for the government, analytical approaches for disposing of nuclear waste, and software engineering for embedded software systems. CSA broadened its expertise through acquisition of companies specializing in the areas of reconnaissance, communication, intelligence, and real-time weather information. These capabilities have enabled CSA to strengthen its market position as well as to break into new markets.

Then, in 1991 CSA ITSELF was acquired by a leading global information services holding company. The holding company's businesses were focused on the data intensive financial information and communications/ computer information markets. Today, CSA has more than 2600 employees, with annual revenues in excess of $385 million, and more than 25 offices throughout the United States and the United Kingdom.

SITUATION

In January of 1996, the firm's CEO and a group of senior CSA managers began evaluating the company's position and thinking about the future of the company. They knew that the world was changing and could easily leave the firm behind if changes were not made. Many external changes were occurring that had an impact on the company. For example, there was a continued decline in the Dept. of Defense budget, with more competitors strongly competing for the remaining customers. Also, major prime contractors were targeting CSA's professional services business. At the same time, numerous external job opportunities for CSA employees were causing good employees to leave the firm.

Although CSA was doing well, the CEO knew that past performance was no guarantee of future success, and concluded that some key changes in how the company did business were necessary to sustain its record of success. The CEO knew that CSA would have to change whether it was directed to or not. During the early part of 1996, the CEO and other managers met with the employees to discuss what was happening in the various markets and why the firm needed to change.

CSA explained to its employees that several of the firm's goals were not being met and cooperation throughout the organization must improve to better serve customers. The company also recognized the need to improve the depth and focus of its technology/experience base. Lastly, in order to support and achieve growth targets, CSA had to improve its own technology infrastructure as well as curb turnover rates and competition for new employees. The CEO and managers also identified and presented the factors necessary for the change to be successful. The firm needed strong leadership that could involve employees in future activities but at the same time hold those employees accountable who did not accept those new company strategies.

The CEO held meetings with employees and ended each of them with this quote, "What separates the great companies from the good companies is the ability to adapt to the changing environment before being forced to change by a financial or business crisis." The CEO traveled to several of the company's offices to personally present the situation. For the locations he was not able to reach and for employees who missed the presentation, a video was put together and distributed to each and every office.

THE CHANGE PROCESS

CSA had never undertaken a formal change effort before and knew that a very high percentage of these types of programs fail. To avoid mistakes, CSA hired an outside consultant who had worked with other successful companies such as GE, Disney, and PepsiCo. As a change agent, the consultant provided the company with a ten-step process that was used to guide the change effort. These steps included communicating a sense of urgency, and to develop a clear, strategic framework within which change could occur. Also, the firm needed supportive managers that could focus on big ideas and involve people in the process. Management had to set realistic targets, obtain better coordination, benchmark important measuring points, and to find ways to relieve the pressure on all employees.

CSA began the change process in February 1996 with the CEO and top-level managers informing and enlisting the aid of all managers. The consensus of the CEO and managers was that

the change process should set ambitious goals and institute change in areas that would have a beneficial and lasting, strategic effect on the future of the company. To do that, three task forces for addressing critical issues were created. These three task forces were:

Corporate Values Task Force. The CEO and managers felt that it was important to define the values of the company that should endure even in the face of change. This task force was chartered to identify and articulate the firm's enduring values.

Pricing Task Force. This task force was chartered to look at how the firm constructs its labor cost multipliers, how it compares with competitors, and what actions could, or should, be taken to reduce direct and indirect costs so it could be more competitive.

Operations Task Force. The charter for this task force was to investigate the issues surrounding alternative pricing strategies. This group would focus on making the firm more competitive while at the same time maximizing profits.

While the task forces were researching and reviewing their tasks, the CEO and management began development of a strategic framework. The framework began with a formal survey of customers, followed by an assessment of markets, competitors, and core competencies. The framework developed provides a high-level look at CSA's guiding mission, values, targets, and strategy for the next several years.

Once the strategic framework for the firm was developed, the change efforts were greatly accelerated. In July 1996, the "Transformation Staff" was appointed. This staff was made up of five employees who were reassigned to oversee the change efforts on a full-time basis. The transformation staff turned its attention to four major elements of the change process. These elements included the following: Being a great place to work – everyone must realize that people are the core of the company's capabilities and must enjoy their work. Sharpening the competitive edge – technologies, costs, skills, processes, etc. must all fit. Maximizing national security – the company must refocus on the core business without the exclusion of commercial or government diversification efforts. Thinking big – the company must have a large impact on any new markets entered or opportunities pursued, and must apply resources wisely to each activity.

Then in August, with the aid of senior managers, the change process was introduced to the employees. Again, the reasons for change and the requirements necessary for successful change were addressed, along with the 'Big Ideas,' which were the bases for the change process. The introduction of the four 'Big Ideas' presented a major opportunity for employee involvement and for employees to work as change agents for the company. The idea behind recruiting internal change agents was to actively involve CSA employees in the change process and obtain their commitment to the future of the firm.

It was recognized that if employees acted as change agents they could help identify areas that needed change, help to flesh out the challenges associated with changes in a particular area, recommend alternatives and timetables, communicate findings, and finally could promote and assist in implementation. At this time, two important groups in the change effort were identified (one internally focused and one externally focused) and began to address the first two big ideas.

1) Great Place to Work Task Force. This group was given the task of identifying, defining, and setting priorities, and then recommending specific actions that would make CSA a great place to work. This task force used employee insights gained through group feedback, surveys, and one-on-one interviews to understand what changes were needed to make CSA a better place to work.

The group also looked externally by reading articles highlighting best practices and by visiting other companies to learn how to succeed in achieving an engaged and empowered workforce. Changes were implemented immediately after approval or within 90 to 120 days of approval. Some major changes that were implemented included an enhancement of the flexibility of the work environment through casual dress, flexible work schedules, and a pilot program for telecommuting. In addition, an Employee Awards Program was begun to recognize excellence and reward outstanding performance by individual employees. Finally, the firm eliminated bureaucratic procedures to help streamline decision-making and greatly reduce the number of approvals required on the company's most used forms. The firm encouraged the notion of fun in the workplace with the creation of 'fun teams' across CSA to bring people together and build team spirit. A program called 'life works' was introduced that provided information and consultation to support employees in facing the challenges of balancing work and family commitments.

2) Sharpen Our Competitive Edge Task Force. This group's purpose was to identify, define, set priorities, and recommend specific actions that would make CSA more competitive in its markets. This task force spoke with a large number of people to collect input and suggestions to help in planning. These benchmarks became instrumental in developing strategies to help CSA become more competitive in the industry. The company began to implement changes within 90 to 120 days. Some of the major implemented changes were to publicly reward and recognize those employees who had contributed exceptional technical performances to CSA or to customers. The firm provided intensive, high-quality training to a sizable number of staff members in strategically targeted technology areas. The company's internal R&D programs were enhanced through a concentration of efforts on fewer but larger programs that were aligned with corporate technological priorities. The firm recognized individuals who achieved advanced degrees through a tuition reimbursement program, thus demonstrating the value of having highly educated professionals. The potential for staff rotation between programs and geographic locations was considered to foster career growth and renewal for employees.

At this point, it was time for CSA to address issues more specific to individual groups and business units. These issues dealt with global, cross-organizational retention and competitiveness. The next two ideas, maximizing national security growth and thinking big, were to be targeted with task forces that would begin working in 1998. The groups would follow the same processes as its predecessors. The last two ideas would require the management team to continually ensure that line and administrative organizations recognized their responsibility for ownership of the transformation of the organization.

CSA was very successful in implementing the changes concerning being a great place to work and in strengthening the competitive edge ideas. The CEO, management, and many employees felt that the company did a great job in implementing the changes. Many of the employees appreciated the company for pursuing the great place to work idea first. In regard to the 'strengthen our competitive edge idea,' many employees felt that the changes would help CSA to be more successful, but only if the entire company truly makes a commitment to succeed.

Of course, along with those employees that respected the efforts and changes, there were those who disliked the whole process. While a small percentage of the employees felt that although some of the ideas were great and could succeed, others thought the company just wanted to look

good on paper. The majority of the employees, however, supported the changes that were implemented.

DISCUSSION

Smooth implementation of organizational change requires broad support for it to be successful. In this case the firm started the change process on a positive note by making it a better place to work. This action on the part of the firm communicated that the employees were the most important part of the change. Credibility by firm management is extremely necessary when making major changes in processes and activities. The majority of the employees thus bought in to the changes and helped to make them work instead of passively resisting the entire process.

FUTURE EXPECTATIONS

Although, the CEO and management know that while many important changes have been made thus far, they also know that there is still much to do to strengthen CSA and ensure the future desired by all. They feel that the next stage in the change process is about the business units and individual groups and the role of each in CSA reaching that future. They have no doubts that the change process of CSA will only succeed through the involvement of all of its many employees.

SOURCES

Company web site, interviews with selected employees, and various annual company reports.

COMPENSATION AND MANAGERIAL TURNOVER: WHEN SAMTEC'S INCENTIVE PROGRAM CREATED DYSFUNCTIONAL TURNOVER

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Ron Cheek, Morehead State University
Martha L. Sale, Morehead State University

CASE DESCRIPTION

This real case, set in the mid-1980's and ending in 1997 places the student at a critical decision point about a bonus system Samtec, a high-tech employer with under 200 employees at its Indiana plant, has in place. The generous performance-based bonus can double the modest incomes of plant assemblers, but is making managers rich. Three of these managers, who are received bonuses of up to three times their salary for several years in a row, have resigned from Samtec to start their own businesses. Students are put in the position of the owner and top managers and asked whether they should change or eliminate these huge bonuses. The Freshman and Sophomores will be able to discuss the effects which they think these bonuses are having. Juniors and Seniors will profit from discussing whether there are ways to change the bonuses and still accomplish Samtec's goals. Seniors and masters-level students should profit from a deeper discussion of whether bonuses should match the strategy of the organization, and what other incentives might be available which are appropriate. Discussion in class can take as little as thirty minutes (to simply address Samtec's bonus system) or as much a ninety minutes if all of the compensation alternatives and Samtec goals, philosophies, and situations are discussed. The instructor can be ready after spending about thirty minutes with the materials.

CASE SYNOPSIS

This case examines the use of incentive pay at a small high-tech company, Samtec. Bonuses based upon continuing high company profits are doubling the income of the common assembly hourly employee. Managers are receiving bonuses over $100,000 per year each year for many years. In 1986 over half of the top managers resign to start their own businesses and Samtec is forced to reassess the effectiveness of their bonus formula and system. The case includes Instructor's Notes which contain additional update information in the Epilogue along with Discussion Questions and suggested answers.

PART I: BACKGROUND OF SAMTEC

Sam and his wife Betty Shine started a small manufacturing company in Southern Indiana to supply tiny wire connectors made of platinum, gold, and other metals to the fledling computer

industry in 1976. Sam lead not only in originally defining the mission and strategy of the company, Samtec, but lead in designing its effective Human Resource approaches as well.

Today, Samtec, Inc., is a worldwide manufacturer of PC board level interconnects. Worldwide Samtec revenue is $125,000,000. Samtec has 5 manufacturing plants and a total of seven offices around the globe including offices in Scotland, Singapore, Germany, France, Italy, and Japan. Samtec is still privately held and continues to employ about 200 employees at the Indiana plant and office. The son of Sam and Betty is now the president, John Shine. Samtec, Inc. is ISO9001 registered with a 4-A1 Dun and Bradstreet rating, the highest available for a corporation this size. Samtec is recognized as the service leader in the connector industry.

Part of the founding strategy of Samtec was a niche strategy of providing fast and "sudden service" to manufacturers and industry users in a scheduling bind. This strategy demands that the workforce be willing and able to hurry orders, often small, through the manufacturing processes using the less stable "job shop" scheduling approach. In contrast, large manufacturers in the area, which includes Louisville, Kentucky, used more controlled scheduling approaches which leveled the work required of the employees and provided a more stable environment. Further, the Shines realized that supplying computer board connectors was a relatively new industry which was dependant on another fairly new high-tech industry - PCs and the expansion of computer technology. Being part of the early stage of the product cycle often creates instability and perceived insecurities among employees.

There were also important internal factors which effected the original personnel policies which were not necessarily linked to the strategy of Samtec. From an internal aspect, the work of producing and inspecting tiny connectors made of valuable metals can be considered light assembly or inspection work. In fact, the modern facility is comfortable and air conditioned. Further, while the production duties require detail and good eyesight, training requirements for the manufacturing jobs are not extensive enough to consider the jobs "highly skilled". Therefore, the majority of the staffing requirements are for semi-skilled, light assembly jobs.

There are least a couple of important external factors which are important to Samtec's personnel policies. Barriers to recruitment included name recognition, location, and skill requirements.

Since the development, manufacturing, and distribution of computer and solid state connectors deals with industrial clients, rather than the household consumer, few people outside the industry are likely to hear about Samtec and its products. This means that from a household consumer standpoint, Samtec is a very low profile employer.

The attractive new industrial park where Samtec chose to locate is in New Albany, Indiana, which has a limited population of only 14,500. In the 1970s the population was well below its current level. New Albany is located north of the population center of the region, Louisville, Kentucky, where the population is over 600,000. Most residents of Louisville would have to drive to, then through, the congested downtown area before entering southern Indiana. This means that the most likely applicant pool is limited to the small towns in and around New Albany.

The development of both the products (connectors and related hardware) and the manufacturing technology to produce these products requires a small but critical staff of specialized engineers. Historically, recruiting for engineers has been very competitive in the Louisville area.

Considering both the internally and externally driven challenges to staffing, the Shines decided to install a compensation and benefit package which would meet these challenges. As sole

proprietors, the Shines decided that they wanted to share a significant portion of the profits with the employees. Sam told employees "I would rather split the company's profits with my employees than split it with the IRS." While job technology, community relations, managerial style, workplace justice, training, and other important issues were also focused upon, Sam believed that the total compensation program was a key to successful staffing in New Albany. In fact, the plan was for Samtec's compensation to be well above that expected based upon the location and skill.

PART II: THE BONUS

First, Samtec decided to use a wage survey to reveal the average wages for benchmark jobs, including light assembly. Such wages are higher in the urban areas of the region and somewhat lower in the more residential or rural areas.

Second, the decision was made to not focus upon the base wage as the special attraction of the pay approach. Samtec decided to pay the average wage (for the residential area) of the wage survey as its base wage. Sam was convinced that the sharing of any Samtec profits needed to be linked to performance.

Third, a calculation or equation needed to be determined which would link any profit-based with the performance(s) of concern to the Samtec owners and management. This required Sam and the five top managers to decide just what results they wanted to reinforce with their incentive approach.

Sam was dissatisfied with the typical profitsharing plans which were common in the late 1970s. Typically, employees received some percent of their salaries based upon the general profit results of the company for which those employees worked. Many companies would pay "up to 9%" (or whatever number) based upon the fact that the company was profitable that past year. Unfortunately, this generally does not provide a very clear link between the work or effort of the individual and the bonus received. In large companies, or in international companies, the efforts of any one individual are generally unrelated to the profits of the employer. Perhaps the only behavior being reinforced in such profitsharing schemes is that of staying with a profitable company.

Sam also wanted to help spawn entrepreneurs. He had started as an employee and had later ventured out successfully as a business owner. He stated that Indiana and, indeed the nation, needed for more people to step out and try to make a success in small businesses. Sam, later recognized as Entrepreneur of the Year in Indiana, philosophically believed that small businesses were good places to work and good for the economy. Sam knew that entrepreneurs need capital.

Based upon a determination of what performances were to be rewarded, two formulas were determined: one for nonmanagerial employees, and another for managerial employees.

Nonmanagerial employees, primarily 150 assemblers, receive a point value determined by job evaluation. Harder and more advanced jobs had a higher base wage and higher point values. These job evaluation points are then multiplied by the performance appraisal score. The review or performance appraisal reflects the performance of that individual over the past twelve months. Seniority was also given some weight. These three factors are then multiplied by a Samtec profit allocation amount, which is based upon the profits of the past year.

The results for many years in a row, through the 1980s, was that the assembler with good performance would receive a bonus equal to that assembler's annual income. For example, if the

assembler made $10 per hour ($20,800 per year) then the assembler might receive about $20,000 in year-end bonus. An inspection of the plant parking lot always revealed a lot of new cars in January after the pre-Christmas distribution of bonus checks.

The fifteen managerial employees were under the same formula except another factor was added. The factor of meeting and exceeding departmental and plant goals (as appropriate to the job) strongly effected the formula. The effect of this added element in the bonus formula changed the functional maximum (there was no absolute maximum) from a factor of 1 times the annual base pay to a factor of about 3 times the base pay. The results were that for years without interruption a manager making $45,000 per year would receive a year-end bonus of $135,000. The effect of this huge comparative bonus was well beyond that of new car purchasing.

PART III: REASSESSING THE BONUS

In 1986 Sam and the Samtec managers had to deal with an unusual problem. Three of the top five managers had resigned. The reason these three top employees gave was that they had accumulated so much money over the past five years or more that they were each ready for a life style change. One opened a plant similar to Samtec and the other two also opened their own businesses. While Sam and the coworkers of these three were certainly outwardly happy for the exiting managers, they were also very concerned about whether the bonus system, as implemented, was effective for Samtec.

On the short term, the loss of three of the top five managers at once put great stress on the organization. There was some fear that other managers might decide to resign. Further there was a lot of discussion among nonmanagerial employees about the greater generosity of the managerial bonus.

On the long term, Samtec thought that it should reexamine the amount, formula, and timing of its bonuses. Sam had desired a bonus system which would create entrepreneurs. This goal was being met. However, Sam had imagined key employees leaving only one at a time. The formula was based upon individual performance factors and also included departmental or plant performances for managerial employees. Sam had always paid the bonuses prior to Christmas to enhance the holidays for his employees. Employees were growing to expect this large annual bonus. Sam predicted that there would be years in which there was little or no profit to share. Should the bonus system be changed to “prepare” employees for this likely event?

Samtec brought in one of the authors as a consultant at this point.

DISCUSSION QUESTIONS

1. Based upon the facts presented would you recommend that Samtec change any part of the bonus system? If so, would you change both the managerial and nonmanagerial bonuses? Give the details of any changes you recommend.

2. Are the goals and performances which are built into the current formulas appropriate for Samtec’s stated situation, philosophy, and strategy?

3. Explain how your recommendations reinforce Samtec's philosophy and strategy, and explain if your recommendations properly reward the performances and goals seen as important by Samtec.

4. What is your approach to preparing employees for a possible year(s) in the future when there may be no profits to share, and therefore, no bonus check.

5. Would you like to work for Samtec?

SOUTHWEST AIRLINES: WHEN ARE WE NO LONGER SMALL?

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CASE DESCRIPTION

Herb Kelleher sat staring out of his window reflecting on the past year of events. The annual report for 1996 was about to be released to the general public. While most of the captions within the report highlighted another successful year for the carrier, Herb could not help but wonder about some changes for the future.

Reminiscent of the early years, government intervention was trying to deliver some severe curve balls to the company. Of greatest concern was a new tax structure being imposed on air travel. While some attempt at hedging against the impact of this new legislation had already occurred, those airlines flying short-haul, frequent flights are still the most effected.

Also, with Congress giving the go ahead for airlines to fly long distance from Love Field, increased carrier traffic is a certainty. Not only will there be increased competition out of Love Field, but with increased congestion comes air traffic risks.

first airplane took off at Love Field in downtown Dallas in June of 1971. This period involved There have also been some recent signs that the once impenetrable armor of company morale was beginning to show some cracks. While the dispersal of personnel has become dramatic over the last several years, the glue that seems to have held the company together remained its "CEO and general hero", Herb himself.

HISTORY

The early years provided numerous challenges to Southwest, and set the stage for what has followed over the last twenty-five years of operations. As management of the company insists today, this is when the *Southwest spirit* was born.

In 1996, Rollin King, a well-respected businessman of San Antonio, came to Herb Kelleher with an idea too preposterous to ignore. As Herb sat in his law office where he had been practicing for several years, he listened to King's vision of starting a Texas airline that would serve Dallas, San Antonio, and Houston using heavy jet equipment.

Although this idea was novel for Texas, it had already proven itself in California (a state very similar in regard to geographic separation of major cities within a state) through PSA and Air California. Both of these carriers had been extremely successful with intrastate coverage, even during a period of high government involvement.

Because of his legal prowess (not to mention his entrepreneurial spirit), Herb Kelleher was an ideal candidate to assist in getting the carrier off the ground. It took over three years from the time that Herb filed the initial application to fly these routes before the considerable legal positioning to counteract the activity of other competitors that were flying these routes—Braniff, Texas International and Continental. Numerous suits were filed against Southwest, and the early years involved standing up against these giants in the courts. These battles finally culminated with the U.S. Supreme Court refusing to hear the complaints of the other carriers, and Southwest was finally free to fly the skies of Texas.

The battle was not over yet though. The next two years of striving to become profitable was the next hurdle to clear. Then, just when the black ink was hardly dry, Southwest was again taken back to court by the cities of Dallas and Fort Worth for refusing to move their operations to DFW International Airport. Once again the fight went all the way to the U. S. Supreme Court. As before, Southwest emerged victorious.

Through these hardships, as well as those encountered after the implementation of the Airline Deregulation Act of 1978, Southwest developed its personality of doing things unconventionally. This maverick attitude continues to permeate throughout the company to this day.

As the most recent annual report states, the company has just completed their twenty-fifth year of profitable performance. Southwest has growth each year from a regional carrier with four airplanes to one with over 243 airplanes today, and serving a substantial part of the country. They must be doing something right.

MARKETING

Promotion

Southwest has long been known for its creativity in regard to promotion. Although the public was very cognizant of Southwest's ads, it was often more for each ad's impact rather than the quantity of ads. As Kelliher once said, "…we couldn't afford much out of the pocket, so we had to spend out of the mind." These ads certainly caught not only the attention but also the affection of the customers.

This flair for creativity didn't end in the seventies. A good example of this can be seen if this example of an ad that appeared in 1992. When Northwest Airlines advertised that they had the highest customer satisfaction level in the industry (even though Southwest was not included in the sample), Kelliher responded with this satirical essay.

A recent trend in promotion used by Southwest for those that are "connected" is the use of the Internet. While their home page (www.iflyswa.com) is used for reservations and as a source of schedules, it provides considerable information and entertainment for anyone interested in the firm.

Price

Low prices have always been the stalwart for this company. For Southwest it is more than just a functional strategic decision, it is a way of life. As the company's 96 Annual Report declared: *"We're not a low fare airline, we're THE Low Fare Airline. The difference isn't in our prices; it's*

in our philosophy." This is typically reflected in their promotion as can be seen in response to the ever present price wars within the industry.

As discussed in operations of the firm, this can only be done when you have extreme control over your costs. Many firms, not as efficient as Southwest, have tried this approach with little to no success.

Product/Place

While stressing a no frill product of transportation from point A to point B, Southwest has been extremely successful in customer satisfaction. As Herb recently pointed out to shareholders, the company had won its third annual Triple Crown for best baggage handling; best on-time performance; and fewest customer complaints per customer carried. This is very impressive considering that Southwest flew 624,476 flights, carrying 42,742,602 passengers. In addition, they were recognized as first in the Airline Quality Rating statistics.

Although the company had been started on the concept of inter-state Texas, flying between Dallas, Houston and San Antonio, their current route coverage reflects a strong national coverage. The carrier now provides service to 49 cities in 24 states with numerous localities requesting air service.

TABLE 1: Southwest Airline's Longer Routes

Nashville, TN	Oakland, CA	1,959
Nashville	Los Angeles	1,797
Nashville	Las Vegas	1,588
Albuquerque, NM	Orlando, FL	1,547
Louisville, KY	Phoenix, AZ	1,507
Albuquerque	Tampa, FL	1,498
Kansas City, MO	Oakland	1,497
Nashville	Phoenix	1,450
Kansas City	Los Angeles	1,368
New Orleans, LA	Phoenix	1,314
Houston, TX	Las Vegas	1,235
San Antonio, TX	Los Angeles	1,210
St. Louis, MO	Salt Lake City, UT	1,167
Kansas City	Las Vegas	1,146
Orlando	San Antonio	1,037
Orlando	Austin	998
Baltimore	Kansas City	961
Providence, RI	Nashville	906
Las Vegas	Seattle, WA	865
Austin	Phoenix	864
Orlando	St. Louis	861

In addition to their increased geographical coverage, Southwest has engaged in their effort to increase the distance of their flights. While this approach is partially due to the vast expansion made in its geographical coverage, others would argue that it is in response to recent tax law changes. In July 1997, Congress implemented a new tax structure effective October 1, 1997. The basic change is to eliminate the flat ten percent tax on ticket prices and to implement a flat tax per flight. Therefore, a flier would be charged the same tax for a 400 mile flight as it would for a 1,000 mile flight. For short-haul frequent flight carriers such as Southwest, this represented a considerable increase in taxes for its customers. Further, for a firm that prided itself in offering affordable airfare, this represented increased costs for its customers. The increase in longer flights (more than a dozen over 1,000 miles) equates to an increase of two and one half times its average flight of 410 miles.

Things have not always gone smoothly for the carrier as they experience these massive growing pains. Probably one of the darkest days for Southwest occurred on January 11, 1995—a day referred to by the company as *Black Wednesday*. It was on this day that, due to bad weather in five of the Midwest cities the company serviced, that the company almost lost control. It was so bad that the company, which at the time was monitoring all scheduling with paper and pencil, lost track of scheduling for all five of those cities. This situation escalated to the point that by the next day the company was looking for crews and airplanes that were scattered all across the country.

EQUIPMENT

Southwest has for many years been recognized as a carrier with one of the youngest fleets in the industry. The company continues to follow the philosophy of utilizing only one type of aircraft—Boeing 737s. As Table 2 shows the average age of this fleet is only 7.9 years which is well below the industry average. Of the total number of aircraft, 124 are owned and 119 are leased.

In addition to the general benefits associated with a newer fleet, 81 percent are also equipped with the quieter, more fuel efficient Stage 3 engines. Of the older planes,

TABLE 2: SOUTHWEST AIRLINE'S FLEET

737 TYPE			
200 SERIES	122	16.1	47
300 SERIES	137	6.0	171
500 SERIES	122	5.7	25
TOTAL / AVERAGE	133	7.9	243

the company has order 20 hushkits (with options for 14 more) to be installed to allow these planes to meet Stage 3 noise standards.

Southwest will continue to ensure the youth and efficiency of their fleet by the aggressive acquisition of the newest version of the 737—the 700 model. The arrival of the first plane is scheduled for the fourth quarter 1997. The new 700 series will fly faster, farther, and higher than the previous models.

LEADERSHIP

Even though Herb Kelleher might disagree, at the center of the effectiveness of leadership within the company is Herb himself. It is through his unorthodox delivery of common sense principles that leaders at Southwest inspire the workers below them.

Herb suggests we need only follow a few simple rules to motivate people to do their best. These rules include: Walk your walk (do what you say you are going to do); Focus on things you can control; Be prepared; Sharpen your political skills (politics is really only dealing with people); Love people to action; and Listen for more than you hear.

SOUTHWEST AIRLINES OFFICERS

Herbert D. Kelleher
Chairman of the Board, President, and Chief Executive Officer

Colleen C. Barrett
Executive Vice President Customers and Corporate Secretary

Gary A. Barron
Executive Vice President Chief Operations Officer

John G. Denison
Executive Vice President Corporate Services

Carolyn R. Bates
Vice President-Reservations

Alan S. Davis
Vice President-Internal Audit and Special Projects

Luke J. Gill
Vice President-Maintenance and Engineering

Michael P. Golden
Vice President-Purchasing

Ginger C, Hardage
Vice President-Public Relations and Corporate Communications

Camille T. Keith
Vice President-Special Marketing

Gary C. Kelly
Vice President-Finance, Chief Financial Officer

William D. Lyons
Controller

Pete McGlade
Vice President-Schedule Planning

William Q. Miller
Vice President-Inflight Service

John D. Owen
Treasurer

James F. Parker
Vice President-General Counsel

Robert W. Rapp, Jr.
Vice President-Systems

Ron Ricks
Vice President-Governmental Affairs

Dave Ridley
Vice President-Marketing and Sales

Joyce C. Rogge
Vice President-Advertising and Promotions

Roger W. Saari
Vice President-Fuel Management

Elizabeth P. Sartain
Vice President-People

Paul E. Sterbenz
Vice President-Flight Operations

Keith L. Taylor
Vice President-Revenue Management

James C. Wimberly
Vice President-Ground Operations

SOUTHWEST AIRLINES
CONSOLIDATED BALANCE SHEET
For the Years Ended December 31, 1995 & 1996
(in thousands except share and per share amounts)

	December 31, 1996	1995
Assets		
Current assets:		
Cash and cash equivalents	$581,841	$317,363
Accounts receivable	73,440	79,781
Inventories of parts and supplies, at cost	51,094	41,032
Deferred income taxes	11,560	10,476
Prepaid expenses and current assets	33,055	24,484
Total current assets	750,990	473,136
Property and equipment, at cost		
Flight equipment	3,435,304	3,024,702
Ground property and equipment	523,958	435,822
Deposits on flight equip. purchases con.	198,366	323,864
	4,157,628	3,784,388
Less allowance for depreciation	1,188,405	1,005,081
	2,969,223	2,779,307
Other assets	3,266	3,679
	$3,723,479	$3,256,122
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$214,232	$116,530
Accrued liabilities	380,747	349,419
Air traffic liability	158,098	131,156
Current maturities of l-t debt	12,327	13,516
Total current liabilities	765,404	610,621
Long-term debt less current maturities	650,226	661,010
Deferred income taxes	349,987	281,650
Deferred gains from sale and leaseback of aircraft	274,891	245,154
Other deferred liabilities	34,659	30,369
Stockholders' equity		
Common stock, $1.00 par value: 680,000,000 shares authorized; 145,112,090 and 144,033,273 shares issued and outstanding		

in 1996 and 1995, respectively	145,112	144,033
Capital in excess of par value	181,650	162,704
Retained earnings	1,321,550	1,120,581
Total stockholders' equity	1,648,312	1,427,318
	$3,723,479	$3,256,122

SOUTHWEST AIRLINES
CONSOLIDATED STATEMENT OF INCOME
(in thousands except per share amounts)

	Year ended December 31,		
	1996	1995	1994
Operating revenues:			
Passenger	$3,269,238	$2,760,756	$2,497,765
Freight	80,005	65,825	54,419
Other	56,927	46,170	39,749
Total operating revenues	3,406,170	2,872,751	2,591,933
Operating expenses:			
Salaries, wages, and benefits	999,719	867,984	756,023
Fuel and oil	484,673	365,670	319,552
Maint. materials and repairs	253,521	217,259	190,308
Agency commissions	140,940	123,380	133,081
Aircraft rentals	190,663	169,322	132,992
Landing fees and other rentals	187,600	160,322	148,107
Depreciation	183,470	156,771	139,045
Other operating expenses	614,749	498,373	456,116
Total operating expenses	3,055,335	2,559,220	2,275,224
Operating income	350,835	313,531	316,709
Other expenses (income):			
Interest expense	59,269	58,810	53,368
Capitalized interest	(22,267)	(31,371)	(26,323)
Interest Income	(25,797)	(20,095)	(9,166)
Nonoperating (gains) losses	(1,732)	1,047	(693)
Total other expenses	9,473	8,391	17,186
Income before income taxes	341,362	305,140	299,523
Provision for income taxes	134,025	122,514	120,192
Net income	$207,337	$182,626	$179,331
Net income per share	$1.37	$1.23	$1.22

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COMPETING IN THE HIGHLY COMPETITIVE ISP INDUSTRY FROM THE VIEW OF A SMALL FIRM

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CASE DESCRIPTION

The case focuses on the business strategies of a small, local Internet Service Provider (ISP) as the ISP industry enters the shakeout period. A secondary issue is how a small firm can compete with the marketing muscle of large ISPs such as American OnLine and CompuServe. The case is suitable for upper-division courses in strategic marketing management and business strategy. The case can be presented in an hour with one hour preceding to review the volatile industry trends.

CASE SYNOPSIS

Based on industry analysts' reports, the Internet Service Provider (ISP) industry is entering the shakeout period. Large ISPs such as American OnLine (AOL), Microsoft Network (MSN), Prodigy, CompuServe and AT&T have the marketing muscle to compete in a national market, and it is the smaller ISPs that must fight to survive and grow. With the growth in personal home computers, the industry demand for internet service will continue to grow. Many small ISPs feel they have a chance for a part of the market share by focusing on customer service. But, most household consumers view internet service much like a household utility service; thus the industry competes in a commodity-based pricing structure.

CyberView began as a spin-off business of a larger corporation's internal information systems department in early 1994. Now after four years, the ISP business unit has yet to turn a profit, and the parent company is wondering if it is now time to get out of this business. As competition from large, national ISPs intensifies, CyberView must re-examine its business strategy and do more than just survive the shakeout period. For smaller ISPs, such as CyberView, it is becoming more difficult to price at the standard $19.95 rate with unlimited access time and still maintain their quality service standards. According to industry analysts, customers select ISPs based on the following five criteria in order of importance: (1) service reliability (2) service performance (3) price for monthly fees and setup costs (4) competence and knowledge of customer service and technical support and (5) speed and proficiency of technical support diagnosis and repair. While some small ISPs price lower than $19.95 to attract price-sensitive customers, they are not likely to maintain the service reliability to the expanded customer base. Additional capital expenditures must be made to expand bandwidth and provide the value-added services that larger ISPs can provide to household and commercial customers.

CASE SUMMARY

Bob Dalton, the General Manager of CyberView, just received a telephone call from Tom Salmon, Chief Financial Officer for Cyber, requesting a meeting to discuss CyberView's operating results for the past year and its projections for growth and profitability. To prepare for this meeting, Bob needs the assistance of his marketing manager, Rian Tate, and his sales manager, Jessie Wheaton. The past year's financial reports show that CyberView is close to breaking even after four years of operation. After showing losses for the past three years, Bob was just starting to feel better about the operating results. However, industry trends show that the internet service industry is entering the shakeout period. Bob and his managers must come up with a strategic business plan that will not only help them survive during this shakeout period, but they must have a plan for growth in a very volatile, technology-driven industry.

Cyber, a large manufacturer of computer components, is the parent company of CyberView, a local internet service provider. Cyber's workforce consisted of highly trained mechanical, electrical, and computer engineers that developed many of its systems for manufacturing and management information. In particular, Cyber had developed a very sophisticated internal management information system to connect manufacturing units in its national and international offices. In 1994 Bob Dalton, a software engineer with Cyber, approached upper management with a plan to start an external internet service to the city of Boydton, population 200,000. The demographics of Boydton appeared to be a lucrative market for internet service because of the high educational level of its citizens and the percentage of households with computers. Also, there appeared to be a potential ISP market among the many mid-size and smaller businesses of the region. CyberView could build on its parent company's in-house technical expertise as well as its customer contacts in the computer industry. Furthermore the reputation of Cyber as the leading employer in the area and its international reputation for high quality computer components could help build the customer base for CyberView. The internet service business unit appeared to be a good idea as it allowed Cyber to diversify into another industry.

Four years have now passed and although the customer base for CyberView has grown, Bob Dalton has yet to see a profit from this business. As the internet service technology has improved the added costs of technology have limited the profitability of CyberView in its start-up phase. The standard $19.95 monthly fee seems to be the upper price point for most customers. In fact some of CyberView's local competitors have even priced at $10.95 per month with unlimited service. This pricing scheme has attracted many first time internet users and price-sensitive users. Many of these customers are not aware that these ISPs are not equipped to handle many customers. As a result, these ISPs will provide lower connectivity rates and there is likely to be more downtime problems due to the system overloads. It is little wonder that industry standards reflect that household users change ISPs every six months. Unlike its local competitors, CyberView offers the $19.95 for the first 100 hours of internet usage. Beyond 100 hours, there is an additional $1.50 per hour. CyberView maintains a sophisticated billing system that alerts the customer when they are within 3 hours of exceeding the 100 hour limit. For its business customers, CyberView offers five Internet access plans that varied in range of benefits and monthly costs to the commercial customer. A field sales staff along with technical support personnel would consult with each company to ensure that the network system requirements and the services provided fit with the needs of the customer. CyberView also

held an annual User Conference to help their business and home-based business users on some of the latest technology development and business applications for internet usage.

As Bob Dalton plans for his discussion with Tom Salmon, he realizes that CyberView must be a profitable business unit in order for Cyber to maintain it beyond the four years it has currently existed. Furthermore, competing on price alone will not enable the firm to survive. Bob and his management team must think about how to market their services to a wider audience and to provide a level of customer service that surpasses its competitors. Bob Dalton has called a meeting with his marketing and sales managers, to go over the industry analysis and to formulate a business growth strategy. Bob feels it might be time for CyberView to expand beyond the Boydton region and provide service to a three-state region in order to gain economies of scale in certain facets of the business. CyberView has the upgraded its technology for expanded bandwidth and has established strong relationships with router systems and other technology companies so that the firm is capable of extending its internet service region. Bob feels the reputation of the parent company, Cyber, has certainly helped in these vendor and technology relationships and it is likely to help expand its customer base..

DISCUSSION QUESTIONS

The key discussion questions to be addressed in this case are:

How can a small ISP grow its customer base without diluting its customer service?

How can a small ISP compete with the large ISPs with marketing muscle and partnership relations with computer firms and utility firms?

- How can CyberView gain economies of scale and scope that would help it compete with larger national ISPs?
- Should CyberView use a mass market appeal to households and commercial users or should the firm find a market niche? What are some other market segments they should pursue?
- Should CyberView expand to a three-state regional market or stay focused on the local market with fewer smaller ISPs competing with the national ISPs?
- What type of pricing scheme should be used to attract and retain commercial customers? household customers?
- What value added services should CyberView provide to maintain its existing customer base?

KING FOODS: A CASE STUDY OF THE RISK ASSESSMENT PROCESS

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ABSTRACT

In 1992, a significant study on internal control titled Internal Control – Integrated Framework was published. It was sponsored by the Committee of Sponsoring Organizations of the Treadway Commission, a group of several accounting organizations. The study is often referred to as the COSO Report. In December 1995, the Auditing Standards Board issued SAS 78, which amended SAS 55 to adopt the definition and description of internal control contained in the COSO Report.

According the COSO Report, "internal control is a process, effected by an entity's Board of Directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

(1) effectiveness and efficiency of operations,
(2) reliability of financial reporting, and
(3) compliance with applicable laws and regulations."

In order to meet these objectives, the COSO Report requires that five components of internal control be present:

(1) control environment,
(2) risk assessment,
(3) control activities,
(4) information and communication, and
(5) monitoring.

Companies are currently involved in designing procedures to establish and maintain the five components of internal controls. CPA firms are designing audit procedures to evaluate the five components. Auditors have been evaluating the control environment and control activities components of internal control as part of external audits for decades, but the other three components are new concepts. In reviewing several popular auditing texts, it was noted that three to four chapters pertained to evaluating control environment and control activities, whereas only two to four paragraphs pertained to risk assessment, information and communication, and monitoring.

This case has been developed to describe a Fortune 500 company's risk assessment process (the company's Internal Auditor has asked to remain anonymous). Their risk assessment process consists of the following steps:

(1) identify the threats to an organization,
(2) determine any risks and concerns regarding the threats,
(3) determine how much potential loss is present,

(4) determine the probability of a loss actually occurring,
(5) estimate the risk,
(6) rank the risks,
(7) determine if controls exist to mitigate the above risks,
(8) design or formulate additional controls if necessary,
(9) implement controls,
(10) tests operational compliance of controls, and
(11) evaluate controls.

The case details the company's results of the risk assessment process, i.e., the actual threats and risks identified by the company's management as well as the process used by management to continuously implement the process.

This case is designed to be used in an undergraduate or graduate auditing course. In order for students to learn how to audit a client's risk assessment process, they must first understand the risk assessment process. This case has been developed to provide exposure to one company's process and therefore provide guidance for this understanding.

THEA COUNTY CONSTRUCTION GRANT: AUDIT DILEMMA

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CASE DESCRIPTION

The primary subject matter of this case is the interaction of inappropriate financial dealings with the audit function. It raises a number of ethical, legal and professional issues as well as the dilemma of the actions the staff auditor should take. It is designed for an undergraduate or graduate auditing course, but could be adapted for a senior level or graduate policy course.

CASE SYNOPSIS

Thea County desperately needed a new sewer plant. The five county commissioners applied for a $5 million State grant and the county was awarded $4 million. The project would consist of a design and needs assessment phase lasting approximately six months with an assigned budget of $400,000. The construction phase would begin immediately thereafter and consume the remaining funds over the nine month construction period.

Twelve bids were received ranging from $ 5.5 million to $ 4.2 million. The bids covered both the design and construction stages of the project. The county commissioners accepted the third lowest bid of $ 4.8 million from Gordon Construction. The two lower bids were not accepted because the bids did not include services of a Certified Engineer, which was a requirement of the State grant. A month later the Certified Engineer left Gordon Construction. Since a crucial component of the contract was violated, the county commissioners voided the contract. The commissioners unanimously decided not to go out for rebid. Instead, they contracted with a local company, Castle Construction Company.

Nine months later Brown CPAs L.L.P., was engaged to perform an initial audit for Thea County. Brown had previously audited several smaller counties and was pleased to get Thea's audit. Thea had previously been audited by a sole practitioner who had died during the audit year.

During the evaluation of internal controls in the disbursement cycle, Fred, a staff accountant for Brown CPAs, discovered that the sole owner of Castle Construction Company is a Thea County commissioner. After a lengthy discussion with the audit partner Fred started investigating the potential related party issue. After several days of research, Fred had discovered a number of facts that he summarized for the partner:

(1) Castle Construction Company did not submit an original bid for the project.

(2) Neither Joe King, the owner of Castle Construction, nor any of Castle's employees is a Certified Engineer. However, they did subcontract the review of the construction plans with a Certified Engineer.

(3) *Castle Construction Company does not have any experience building sewer facilities. Their construction activity has focused on farm and industrial storage facilities. The amount of their largest previous building permit is $850,000.*
(4) *Joe, as the project supervisor has received $70,000.*
(5) *The project is not yet at the construction stage and is already $ 57,500 over budget.*
(6) *The county's bank account does not reconcile by $ 90,000.*
(7) *The county clerk, who is solely responsible for the county's checks/disbursements, is Joe King's wife.*

Discussion Questions:

(a) What are the ethical issues Fred faces?
(b) What are the audit issues?
(c) Are there any additional audit procedures that Fred should perform?
(d) To whom should Brown communicate their concerns?

STATE ATHLETIC CLUB: GROWTH CHALLENGES AND OPPORTUNITIES

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CASE DESCRIPTION

The primary subject matter of this case concerns entrepreneurship. Secondary issues examined include strategy, franchising, and supervision. The case has a difficulty level of four, appropriate for senior level courses. The case is designed to be taught in one hour and is expected to require three hours of outside preparation by students.

CASE SYNOPSIS

Athletic clubs grew in popularity in the 1980s in the Northwest. Jack, Sharon, and their son Ben capitalized on this trend by opening State Athletic Club (SAC) in 1985 in Clarkston, WA. Although the club was an immediate success, Jack and Sharon had difficulty retaining their key employees, SAC's weight trainers. Furthermore, in 1990, YMCA opened a club that threatened SAC's survival. Jack and Sharon's response was that they needed to implement one of four proposed strategies. The case is an exercise in strategic thinking for students. One discussion question asks students to conduct a SWOT analysis. Another question focuses on which one of the four proposed strategies Jack and Sharon should adopt. The possibility of franchising is also considered.

INSTRUCTOR'S NOTES

To make best use of the material covered in the case, it should be utilized in an entrepreneurship class after the strategy and franchising topics have been covered. If an instructor does not plan to cover franchising or wants to use to utilize the case directly after covering the strategy topic, it can still be used. In this situation, discussion question number four on franchising should be omitted.

1. Perform a SWOT analysis. That is, discuss SAC's internal strengths and weaknesses, and its external opportunities and threats.

Strengths include: good business location; committed owners; profitable business; almost ten years of learning what does and doesn't work for a Clarkston athletic club; knowledge and experience in the area; personal attention that comes from a family owned business; invested interest in the community; roots in the community; and experience with a wide range of target markets. SAC's

weaknesses are: inability to attract and retain weight trainers; limited capital; Sharon and Jack's limited business backgrounds and management experiences; Ben's lack of management experience or mentoring given his position in SAC; and SAC's past reputation of offering inferior children's programs. Opportunities include: SAC is in a growing industry (physical fitness); SAC is located in a growing community. Threats are: current Clarkston competitors, in particular, the new YMCA plus gyms, swimming pools, etc. in Clarkston ; and other athletic clubs, gyms, swimming pools, etc., in nearby communities.

2. What can be done to reduce the weight trainer turnover?

There are at least two reasons weight trainers do not stay at SAC: salary issues and conflicts with Ben. Salary concerns could to some extent be addressed through the use of bonuses. Jack and Sharon, for example, could decide to share a portion of SAC's annual profits with all their weight trainers, or with those who attain a certain performance level. Of course, to implemented either of these ideas, a process for allocating the profits would need to be established. Regarding conflict between Ben and weight trainers, Ben needs mentoring on how to manage employees. Although he has excellent equipment knowledge, he is young and lacks experience on how best to supervise these "key" SAC employees. If Jack and Sharon are not able to assist him in making changes in his style, they probably need to remove him as a supervisor.

3. Which strategy, of the four discussed, would be best for SAC to pursue? Why?

The first three strategies (children's programs, expand facilities, and reduce prices) are reactive strategies to YMCA's opening in Clarkston. Offering children's programs could potentially lead to more business, but it is an uphill battle based on SAC's former attempts. Expanding SAC's facilities is the most expensive option and Jack and Sharon would probably need to borrow capitol, as they have done in the past, if they selected this route. A concern here is the degree to which they currently are in debt. Also, are they willing to assume more debt given the possible increase in sales may not cover the estimated increase in costs. Reducing prices is the least costly option and, in turn, it offers the smallest possible gain in sales. Again, this option is a purely reactive one to YMCA but it could be easily implemented; hence, it is appealing. The last strategy, targeting upper middle-class and single adult markets, is also attractive. There is risk as to whether these markets are large enough. However, given that Clarkston and the surrounding areas have been growing, the risk is reduced. Also, upper middle-class people and single adults typically have money to spend for memberships.

4. If Jack, Sharon, and Ben were to consider franchising their business, what would they need to have in place? Is franchising a viable option at this point? Why?

Three requirements exist for becoming a franchisor. First, a successful business pattern or formula needs to be developed. Included here are operating instructions, special equipment, personnel policies, and record keeping. Second, a franchising system needs to be formulated. Key franchising system items are trademarks (a word, logo or picture legally reserved for exclusive use),

franchise contract (initial fee, royalty, etc.), advertising strategies, and state and community laws needing to be observed. Regarding trademarks, SAC's logo that is placed on the workout clothing which Jack and Sharon sell would need to be reserved, if this has not yet been executed. Third, resources need to be available to implement the franchise structure. Items included here are the training program for new franchisees and the control system for ensuring that franchisees adhere to their contractual obligations.

At this point in time, it would appear that franchising is not a viable option. Although the owners have accomplished many of the items in the first requirement, no information was presented that they have satisfied the second or third requirements.

STRATEGIC MANAGEMENT OF R & D: A FIELD STUDY

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ABSTRACT

The purpose of this field study/case is to examine the critical factors for a corporation to strategically manage its R & D for competitive advantage.

An a priori model, based on a literature review, was developed integrating organizational, economic, marketing and financial factors that are significant for allocation of R & D scarce resources.

A field study of a growing mid-size company in the medical instrument field was the basis for intensive study, personal interview of key top managers, and data gathering and analysis.

The company developed a model, named Gateway, for managing product introduction for competitive advantage. The Gateway model captures critical information at different stages of product development from design - development - manufacturing - marketing to service throughout the value chain to assess and manage risk on a portfolio basis. The total risk is a function of: technical risk, time risk, and cost risk. The trade-offs between these three risk components are evaluated relative to the mission of each strategic business unit, based on multi-dimensional analysis.

The Gateway model enables the company to leverage its core comptency, avoid hidden risk, and increase its profits.

EMPLOYEE TURNOVER AT FASHION PRODUCTS INC.

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CASE DESCRIPTION

The primary subject matter of this case concerns the causes of employee turnover at the a manufacturing plant of Fashion Products Company. Secondary issues examined include the cost of the turnover and recommendations to improve the performance of the company. The case is appropriate for the junior level or graduate introductory management course or the junior level or graduate Human Resource Management course. The case is designed to be taught in one class hour.

CASE SYNOPSIS

This case illustrates problems at a highly successful corporation that have produced high turnover at its manufacturing facilities. Costs of the turnover are analyzed and recommendations to implement a complete revamping of the corporation's Human Resource Management programs and its management training are exhibited in the instructor's notes that students can compare with their own recommendations.

HISTORY

Neucor Manufacturing Company, Inc., was founded in the early 1900's in New York. From the early 1920's to date, Neucor pursued an ambitious program of growth by acquiring smaller companies. In the early 1970's, Neucor went public and shares were traded over the counter. Late in the 1970's Neucor Corporation was listed on the New York stock exchange. Because of its acquisition strategy, Neucor is a multi-billion dollar company today with several companies under its roof. One such subsidiary of Neucor is Fashion Products Inc. Fashion Products was founded in the mid 1960's in a rural community of west Illinois. Today, Fashion Products is a multi-million dollar company and a market leader in its industry. Neucor acquired Fashion Products, Inc. in the early 1990's. With its corporate headquarters in a suburb of Chicago, a local distribution center and huge manufacturing facility in west Illinois, Fashion Products employs about 2,000 people with about 1,400 employed at the manufacturing facility.

CORPORATE STRATEGY

Since Fashion Products is a subsidiary of Neucor, it is bound by Neucor standards. Since the late 1960's, Neucor has acquired numerous companies. In the 1990s alone, Neucor acquired over 10 major companies, representing over $2 billion in additional sales. Future acquisitions and growth will provide an EPS growth averaging 15% per year. By adhering to a tightly focused business strategy, Neucor has established a sustainable competitive advantage and has consistently attained its aggressive financial objectives. These financial objectives are: (1) Maintain return on beginning equity of 20% or more; (2) Achieve EPS growth averaging 15% per year; and (3) Increase Neucor's dividend consistently with its earnings growth.

INTERNAL ENVIRONMENT

The headquarters in the Chicago area consists of the executive staff, marketing and sales departments. Thus, this facility primarily employs salaried people. Their manufacturing facility consists of engineering, operations, purchasing and planning departments. Of the 1,400 people employed at this facility, about 1,200 are hourly workers and about 200 are salaried.

Fashion's products are considered to be low-tech requiring semi skilled workers. Fashion Products is strategically located in west Illinois. However, after being acquired by Neucor, Fashion Products has been forced to improve its productivity and to adopt the higher standards of Neucor. This has lead to the hiring of young and ambitious professionals who have the "go, get it" attitude. These young professionals prefer to live either in the suburbs of Chicago, or in other urban areas which are 30 to 40 miles away. The reason people commute so much is because the manufacturing facility is located in a remote town of just 5,000 people.

Fashion Products has a hierarchical organizational structure with a top down management approach. Management is highly centralized and employees on the floor are not allowed to make decisions. However, employees can participate in employee teams and try to resolve production or efficiency related problems. Professionals over a certain level are rewarded by yearly bonuses. These bonuses are based on the return on assets. These bonuses range from 0 % to 66%, depending on the position of the employee. Other employee raises are a meager 2% to 4% every year. These raises are 0 to 2% when adjusted for inflation.

The organization structure starts with the CEO of Neucor at the top. The chart shows only the Neucor and Fashion organization structure. It's corporate culture shows that management follows a top down approach. In markets where Fashion Products is competing, management needs to have feedback both from employees and customers in order to move faster than the competition. Marketing executives are unaware of what customers want in new products and hence marketing strategies are poor. This has been demonstrated by some recent failures in new product launches.

CORPORATE ANALYSIS

Fashion Products strengths include: (1) an established brand name that people associate with high quality, (2) deep pockets because it is under Neucor's umbrella, (3) excellent relationships with mass merchandisers that allow Fashion's products to be placed in the most strategic positions on the

shelves, and (4) it is the market leader in its industry and focuses on its core competencies which are fashion and grooming accessories. Fashion Products weaknesses include: (1) poor distribution strategies and (2) high turnover of professionals. Fashion Products opportunities include: (1) retaining experienced professionals to make and successfully market more innovative products, (2) empowering employees to increase the pace that new products hit the market, (3) new product markets and market penetration are strategies which will create synergy and help Fashion Products increase sales (4) Fashion Products can export to Canada and the Latin American countries. Fashion Products threats include (1) intense competition from low cost manufacturers in the orient. (2) high turnover of experienced professionals that increases the cost of new hires, and (3) a very volatile market with short fashion life cycles that requires new products to be developed and introduced very rapidly.

EMPLOYEE TURNOVER AT FASHION PRODUCTS, INC.

In the past, the primary focus of business was profit. Now, Fashion Products is slowly realizing that profits come from productivity and productivity comes from happy and loyal employees. In the 1970's and 1980's the baby boom generation was entering the workforce and reducing the demand for unskilled, semi-skilled, skilled labor as well as for professionals. Analyst believe that between the mid 1990's and 2010, there will be a decline in the workforce. The employee relationship is a formal arrangement but it is a relationship, nonetheless. Like any other relationship, it will be successful only if both parties work at it. Looking at employee turnover data and conducting a systematic analysis of those trends is the first step in trying to reduce the turnover.

In trying to analyze these trends and to project turnover rates, three types of turnovers need to be analyzed (Connor 97). Job related turnover involves those factors over which the employee has direct control. Supervisory training programs can reduce this type of turnover along with clarification of the employer's purposes and identification of job satisfiers. The non-job related turnover issues are those in the employee's personal life that spill over into the workplace. These are factors such as relocation and family influences. Useful practices for this category include employee assistance programs and providing stress management training. The third type is a poor fit between the employee and the firm. Professionals at Fashion Products are hired by direct advertisements in newspapers and magazines as well as through recruiters. Professionals are promoted from within the company, from the same department or from other departments as well. Managerial positions are typically filled in a span of 3 months to 1 year. However, hiring may be delayed due to a hiring freeze. All potential new employees are sent for a psychological and aptitude test. This is a good method to measure a prospective employee's specific job related characteristics. This test measures an individuals personal communication techniques, leadership qualities, self-image, dependability, competitiveness, attitude and stress management.

PERCEPTION OF WORK BY EMPLOYEES

There are several reasons that force people to quit their jobs. Some of these are:

1) Location of the company

Fashion Products is located in a remote town in west Illinois. The population of this town is about 5,000. The nearest interstate is about 25 miles away. Most of the blue collared workers are local residents. However, more than 90% of the white collared workers commute either from the suburbs of Chicago or from other urban areas. It takes the employees about 45-50 minutes to reach the manufacturing facility traveling on state highways having low speed limits. White collared employees do not choose to live locally because of the size of the town and the fact that it has just a couple of schools and poor health care facilities. Commuting is one of the major reasons why professionals quit their jobs.

2) Benefits

A new employee starts off with a one week vacation. Employees in other firms, in similar companies start out with a two week vacation. Managers are rewarded with yearly bonuses and promotions, based on their performance. They are also invited for celebrations when the company has a profitable year. However, other professional staff, technicians and machine operators are left out of these celebrations. Is this conveying a signal that these employees are not important for the firm? Maybe so.

3) Poor relationships with supervisors

When supervisors are hired from outside or promoted from within, there is no training provided to them on managing employees. Not all supervisors have an MBA or even a four year degree; hence they are ill-equipped with proper management skills. This situation causes discomfort amongst employees and is one of the reasons why employees leave.

4) Better salaries elsewhere

Fashion Products is not one of the best paying firms. The living expenses in and around the area are amongst the highest in Illinois. The sales tax is 7%, the state taxes are fairly high as well. Today, when there are more jobs than people, it is easy to get better wages and benefits. The individual has nothing to loose, but the firm looses an experienced employee.

5) Little appreciation from supervisors

A technician typically works from 8 a.m. to 5 p.m. But, to finish up an important project which has cost savings of over a million dollars, he comes in at 4 a.m. and leaves at 6 p.m. The project is completed successfully and the Director of Manufacturing is very happy. The result is that the technician's boss gets promoted to a managerial position. The technician does not even get a few words of praises. Such situations spread dissatisfaction among employees. This technician left within 3 months. He had been with Fashion Products for over 10 years. He had been a very loyal and a hardworking person. Who looses under these circumstances? Obviously Fashion Products. Employees get a feeling that they are just another number.

6) No career advancement

Though the company does try hiring from within if possible, not every employee gets a chance. Some people leave their positions when they want to move higher up the ladder and do not see any chances of being able to do so.

7) Personal reasons

A person may quit if his/her spouse was transferred, or took up a job in another city. More often than not, people leave to be closer to their families. Women may quit if they have to take care of their young kids. Bad health could be another reason.

8) Stress

The individual is stressed out either because the job is too demanding and/or because of personal reasons.

9) Misfit of person and job

The personality traits required for a particular position may not be present in the employee. For example, a salesperson should preferably be a good communicator, organized, people oriented, honest and tenacious. If a salesperson does not possess these skills, it is very likely that if he is hired, he will leave or be fired.

CALCULATING THE COST OF EMPLOYEE TURNOVER

When an employee leaves an organization, it experiences substantial costs. Costs to the organization may include decreased productivity, costs of hiring a new employee, increased training time and other indirect costs. Turnover is usually computed as the number of employees separations divided by the total number in the workforce and expresses as a percentage. Younger, newer, unskilled and blue-collar employees tend to have higher turnover rates than their contrasting groups. Fashion Products does not have a severe organizational wide turnover of blue collared workers. This trend is prevalent in young white collared professionals.

Not only is the quantitative rate of turnover important, but the quality of personnel leaving an organization is important as well. Those who leave may be the company's most valued human resources. Special attention should be given to turnover among employees with unique skills.

The following worksheet is an approximate breakdown of separation costs, vacancy costs and replacement costs:

Separation costs include the following categories:	
Cost of leaving employee's time (30 minutes @$30/hr.)	$15
Cost of administrative functions related to separation (2 hrs. @ $20)	$40
Total Separation costs	$55
Vacancy costs	
Costs of additional overtime (20 hrs. @ $40 for 4 weeks)	$3,200
Costs of additional temporary help (20 hrs. @ $35 for 2 weeks)	$1,400
Total Vacancy costs	$4,600
Replacement Costs	

Pre-employment administrative expenses (3 hrs. @ $20)	$90
Costs of attracting applicants (Advertising, staff time, recruiters)	$10,000
Costs of entrance interviews (5 interviews for 1hr @$40/hr.)	$200
Testing costs (2 potential employees)	$1,000
Staff costs (One 30 minute meeting with 3 people @ $40/hr.)	$60
Travel and moving expenses (1 employee)	$2,000
Sign up bonuses (1 employee @ 8% of salary)	$3,500
Cost of post-employment medical exams	$75
Total replacement cost	$18,925
Training costs	
Cost of informational literature	$20
Formal training costs	$200
Informal training costs (Socializing 1 day @ $40/hr and 1 day @ 30/hr)	$560
Total training costs	$780

Knowing the cost of losing and then replacing an employee will help Fashion Products determining how much it can afford to invest in keeping them. It will also help to analyze whether the investment in keeping the employees is adding to the bottom line (Pinkovitz, 1991). William Mercer, Inc. surveyed 206 medium to large US companies yielding the following:

ANNUAL COST OF TURNOVER PER EMPLOYEE

Estimated cost	% of companies
$10,000 or less	55%
$10,001 - $20,000	16%
$20,001 - $30,000	8%
$30,001 -$40,000	11%
More than $ 40,000	10%

ASSESSING TURNOVER

Fashion Products does not have any established system of exit interviews. Hence there are no official records for the reasons of an employee separation. By carrying out exit interviews Fashion Products can pinpoint major reasons for turnover and can thus improve the factors which will cause employee turnover.

CONCLUSION

Fashion Products tries to recruit the best, develop the best and retain the best employees. The relocation department is disjointed from the development and retention process. Keeping the relocation department involved in a quality human resource process will give Fashion Products a better chance of addressing dissatisfaction among new employees and with managing turnover (Oltman, 1998). The secret to retaining employees is to make the workplace a fun, clean, profitable,

ethical and adventurous environment. Though this statement does not sound like business, this is what the future is about (Lauer & Gebhardt, 1997). The officers of Fashion Products should seek help in redesigning its HRM programs.

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MEDIGROUP PURCHASING, INC.

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CASE DESCRIPTION

The primary subject matter of this case is business strategy and, specifically, the creation by a company of enduring competitive advantage. Related issues include industry analysis and management of customer value. The focus on enduring competitive advantage and how to create it assumes that students have some appreciation of the importance of this issue; for this reason, we suspect the case is most appropriately used at a difficulty level of four (senior) or higher. The case is designed to be taught in one class session of approximately one hour and a half, and is likely to require two hours of preparation time from students.

CASE SYNOPSIS

The case tells the story of the CEO of a Group Purchasing Organization (GPO) for medical products who is wondering what strategy and structure he should establish for a new subsidiary. His task is more challenging because the medical services competitive environment in the United States is currently in a state of flux. The objective of the subsidiary is to attract the business of hospitals, clinics, and other providers of medical services who wish to enjoy not only the lower prices associated with membership in a group purchasing organization, but also to flow the financial benefits generated by those low-cost purchases through to these participating hospitals and clinics on a tax-free basis.

The case contains information on an organizational format (a subchapter t cooperative) which does allow financial benefits to be distributed to members tax-free. The case also contains considerable information on the evolving medical services industry in the United States, together with information on this GPO's customer base, information on competitors, and information on the company itself. In short, enough information to conduct a mini-industry analysis is provided. In the instructor's note, a process for creating enduring competitive advantage is described, and a citation to an expert source of additional readings is identified.

THE SITUATION

December 1994. John Smith stared again at the check and smiled. Three years of absolute agony had ended. The disastrous MEDNET partnership which Medigroup Purchasing Inc. (hence, MPI) had formed with three other Group Purchasing Organizations was finally terminated. Also, this financial settlement from its former partners would allow MPI to launch a new organization to offer hospitals the equity position which MEDNET had promised but never really delivered. Smith got out a pad, and started drafting a memo to his leadership team setting forth his initial thoughts regarding structure and strategy for the new organization.

THE COMPANY

MPI is a Group Purchasing Organization (hence, GPO) for hospitals. The company was founded by John Smith in 1971. Because it handles the purchasing of medical equipment and supplies for hundreds of hospitals and other providers of medical care, MPI is for most manufacturers a large and powerful customer. The company uses this power to negotiate low prices for its members on their purchases of medical equipment and supplies. Thus, hospitals and clinics purchasing through MPI pay substantially lower prices than all but the largest customers choosing to deal with the manufacturer directly. As for MPI, it makes its money through an administrative fee, paid to it by the manufacturers as a percentage of the total revenues on orders placed by MPI members.

A predecessor organization to MPI served clients within the midwest. Over the years, however, many GPOs including MPI have become national in scope. MPI currently has over 19 Regional Directors and Vice Presidents. The major responsibilities of these individuals are to service member facilities and to market MPI programs to prospective accounts in all 50 states. Field reps reporting to these managers are located throughout the U.S.

The key selling tools utilized by MPI sales and marketing staff include a variety of CD Rom, network-based, and/or hardcopy information sources designed to provide MPI members with the latest information on prices of various medical equipment and supplies. Specific tools include the following:

- Electronic Catalogue: materials management information on CD-ROM(also available on microfiche)
- Pharmacy Electronic Pricing System (also available in hard copy and microfiche)
- Laboratory Program: pricing information on pharmaceuticals (available electronically and in hard copy)
- Dietary Program: contracting information available in hard copy

In addition to its administrative and sales staff, and the negotiators responsible for developing contracts with medical equipment and supply manufacturers, MPI has over the years, developed a host of on-staff specialists to assist customers in managing the costs and operations of specific medical functions. Specialists on MPI's staff currently include laboratory, pharmacy, dietary, and materials management. MPI also has a compliance department to monitor and audit member participation in MPI programs and contracts, to ensure that members do receive the discounts to which their participation in MPI programs entitles them. The organization chart in Exhibit 1 identifies other MPI departments including member support services, teleservice, cost analysis, capital budgets, and management reports.

A relatively new area of endeavor for MPI is a division called "BESTPRAC." The mission of this MPI division is "to enhance MPI members' ability to deliver cost-effective healthcare." BESTPRAC does this through a process involving re-engineering, best practice/benchmarking, cost determination programs, and strategic information/group reporting. Through this unit, MPI members are provided on a fee-for-service basis with conceptual and implementation expertise on a variety of specialized areas, including:

- Materials Process Engineering
- Supply Flow Studies (operating room, pharmacy, labor & delivery, procedure-based, per diem-based, capitated-based)

- Procedure Costs by Physician
- Benchmarking Data (materials management operations, clinical repository, financial repository, food accounting cost and trend statistics)
- Implementation of Advanced Materials Systems (JIT stockless)

COMPETITIVE CONSIDERATIONS

In the beginning, MPI's primary competitors were GPOs based on a business model (that is, recruit large numbers of members, use the huge volumes of member purchases to win discounts from manufacturers, and then flow these discounts back to members) very similar to MPI's. In 1981, however, a new competitor called EQUIMED emerged. The business model underlying EQUIMED is a Sub-chapter T Cooperative, an organization form which allows EQUIMED to pass its profits to members tax-free. The hospitals become members, and because many are themselves non-profit entities, this arrangement allows EQUIMED member companies to avoid completely the payment of taxes on the profits generated by their EQUIMED purchases and ownership.

EQUIMED's original purchasing program was neither especially good nor especially effective. Over the years, however, EQUIMED's management team worked diligently to improve it. By 1984, EQUIMED had assembled a substantial portfolio of very favorable contracts with mainline suppliers, was becoming much more competitive, and was attracting (through its equity-based approach) substantial numbers of new tertiary (that is, very large and specialized) hospital members. So, while MPI in 1985 aggressively expanded its operations in both Louisiana and Texas, and acquired a GPO named WESTCO which was serving hospitals in Colorado and Montana, EQUIMED was at the same time successfully selling its services on an equity basis to tertiary institutions in most of the largest U.S. cities. It became clear to Smith and the MPI management team that unless MPI was able to address the equity issue, it was not likely to continue to have access to and/or win major amounts of business from the large tertiary hospitals.

FORMATION AND EVOLUTION OF MEDNET

In 1986, in response to increasing competition with EQUIMED, MPI and three other group purchasing organizations (CLINICARE, based in Southern California, ERIEMED based in Eastern Ohio, and ASTROCARE, based in Massachusetts) formed a company called MEDNET. MEDNET was based in Chicago, Illinois. Like EQUIMED, MEDNET was designed to provide hospitals the ability not only to benefit from large discounts associated with group purchasing, but also to invest in and have an equity interest in the GPO. In other words, the underlying concept was that hospitals would be both owners and customers of MEDNET.

While the concept (or structure) underlying MEDNET was clear, it began to be clear to Smith and his colleagues at MPI that their partners in MEDNET might have different aspirations and objectives. When MEDNET was founded, the four partners had agreed that there should be pro-rata sharing of revenues and equal sharing of expenses. However, over the next several months, MPI's partners protested with increasing vehemence that dividing expenses into four equal shares was not a satisfactory arrangement. This was galling to Smith, especially in the case of CLINICARE, where

MPI had turned over MPI accounts in CLINICARE's service area to CLINICARE, as compensation for their participation in MEDNET.

Late in 1986, Smith accidentally discovered the full extent to which the difference between the objectives and aspirations of MPI and its three partners had diverged. In the mail, Smith received anonymously a 17 page business plan prepared by the three MEDNET partners. Reading the plan, Smith was stunned to discover that his MEDNET partners were engaged in a long-term plan to takeover MPI, and that their initial short term objective was to persuade MPI customers to divert revenues to MEDNET and away from MPI.

Early in 1987, MPI terminated its partnership in MEDNET and initiated a "cease and desist" action in Chicago circuit court. A jury trial was initiated. However, after three years, when the judge named a figure which by Smith's reckoning gave the company back most of what MPI had lost through its affiliation with MEDNET, he agreed to an out of court settlement.

THE EVOLVING HEALTH CARE ENVIRONMENT IN THE UNITED STATES

Health care in the United States is a huge and growing business. Key players in the U.S. health care system include the American Medical Association (the primary trade group for physicians), clinics, doctors, Group Purchasing Organizations (GPOs), Health Maintenance Organizations (HMOs), home health providers, for-profit and not-for-profit hospitals, manufacturers of medical equipment and supplies, nursing homes, nurses, manufacturers of pharmaceuticals, private and public health insurance programs, statewide hospital trade groups, and surgery centers. The system is complex and expensive. However, for individuals with health insurance (approximately 50% of the U.S. population), the system is capable of delivering a very high standard of health care.

Over the decades of the 1970s/1980s, the cost of health care services in the United States increased as much as 10% per annum. In response to these huge price increases for medical services, the federal government revamped the Medicare and Medicaid payment programs. A key provision was the decision to cap the amount that these programs reimburse hospitals for the various medical services which they provide.

The Medicare and Medicaid caps on medical procedures had an extremely powerful impact on hospitals, clinics, and other institutional providers of health care services. Suddenly, providers found themselves scrutinizing as never before the expense side of their operations, attempting to squeeze out enough costs so that the reimbursements provided by the federal government would cover the out-of-pocket expenses of providing the services. Thus was born a huge opportunity for HMOs, GPOs, and other organizations dedicated to the proposition that the costs of providing healthcare could be managed and reduced.

Ultimately, the HMOs, GPOs, and other organizations devoted to the management and control of health care costs achieved a major impact. By the decade of the 1990s, the rate of growth in health care costs in the in the United States had fallen from the double-digit annual increases of the 1980s to single digit annual increases for the decade of the 90s.

THE GROUP PURCHASING INDUSTRY

The trade organization for the industry is the Professional Society for Healthcare Group Purchasing. The society is based in Ladover, Maryland. Articles of incorporation indicate that "society membership is open to executives and senior level managers from healthcare group purchasing and shared services organizations, multi-hospital systems, and other healthcare provider organizations." The purpose of the organization is "to provide educational and professional networking opportunities for the growing number of healthcare executives involved in group purchasing."

The society's 1997 membership list indicates that there are currently 66 GPOs headquartered in 22 states and Canada. Nearly all of these GPOs are located in the east and the midwest, with very few in the south (2 in Georgia) or the west (2 in California, 2 more in Washington). States and numbers of GPOs headquartered in each are as indicated below:

California	2
Connecticut	2
Georgia	2
Illinois 4	
Indiana	4
Kansas	3
Maine	1
Maryland	2
Massachusetts	2
Michigan	1
Missouri	10
New Hampshire	1
New Jersey	2
New York	4
Ohio	7
Pennsylvania	4
Rhode Island	2
Tennessee	1
Texas	3
Virginia	2
Washington	2
Wisconsin	3
Ontario	1
Quebec	1
Total	66

GPO STRUCTURE AND OPERATIONS

Historically, the mission of GPO organizations has been limited to and focused on reducing the costs of medical equipment and supplies for member hospitals. Over time, however, and as

indicated earlier, GPOs including MPI have broadened their product-based focus to include providing specialized services which provide high value and benefits to hospitals and other health care providers. We turn now to consideration of these customers and their needs.

CUSTOMER CONSIDERATIONS

As one of the largest GPOs in the United States, MPI currently represents over 2000 facilities accounting for more than 100,000 beds. Exhibit 2 indicates that hospitals are the largest single customer category. Within this category, MPI has found over the years that small to medium-sized hospitals tend to benefit most from the services and skills which MPI can provide. Extremely large hospitals and/or hospital groups are by themselves large enough to receive volume discounts from manufactures of medical supplies and equipment. Also, these very large organizations and/or groups (for example, Baptist Medical Center in Memphis) tend to have inside their own organization a very large set of specialized skills and departments. Smaller to mid-sized hospitals, however, can't justify the expense of such specialized units and thus benefit greatly from the specialized expertise and services which MPI can provide.

The economic impact on communities of these medical facilities, even the small to medium-sized hospitals likely to benefit most from an affiliation with MPI, can be large. Hospitals tend to employ large numbers of employees, and many of these employees are highly paid. In 1998, the modal income for a newly-graduated medical student starting out as a general practitioner exceeded $160,000. In the small to medium-sized towns and cities in which these hospitals are located, doctors and senior-level medical staff are often among the highest-earning individuals in the community. Thus, not only for quality- of-life reasons but also because of economic considerations, communities are usually very eager to retain and/or support the expansion of local medical facilities.

While most communities are very eager to retain even very small local hospitals, this desire is not necessarily consistent with the new economic realities and the changing payment environment described earlier, in which control and/or reduction of costs has become extremely important. In the short run, joining a GPO has enabled many small- to medium-sized hospitals to achieve substantial cost reductions and to survive. In the longer run, however, these small to medium-sized hospitals face severe threats from large regional hospitals in major metropolitan areas. Most of these large hospitals are working intensively not only to reduce costs but also to increase revenues. One way they increase revenues is to open small clinics in remote locations (that is, in smaller towns and cities throughout their regions). The two primary missions of these satellite clinics are 1) To provide customers in these remote locations with inexpensive treatment for day-to-day medical problems, and 2) To pull as much as possible of the high-cost, high-margin specialist business out of the small to medium-sized local hospitals and into the big regional medical centers. As indicated earlier, developments to date suggest that the satellite clinic strategy places many of the small to medium-sized hospitals, which are MPI's best customers, at substantial risk.

YOUR ASSIGNMENT

Please assume you are John Smith. Please set forth your thoughts regarding the strategy and structure for the new entity you will introduce to replace the failed MEDNET organization.

EXHIBIT 1
MEDIGROUP PURCHASING, INC. ORGANIZATION CHART

CEO

PRESIDENT

V.P. FINANCE	V.P. OPERATIONS	V.P. CONTRACTS	V.P. SALES
*Accounting	*Clerical	*Health Care Info Systems	*19 Regional Directors
*Compliance	*Distribution	*Management Info Systems	
*Info Systems	*Member Support Services	*Marketing	
*Long-term funding	-BESTPRAC		
*Short-term funding	-Capital Budgeting		
	-Dietary		
	-Laboratory		
	-Pharmacy		

EXHIBIT 2

Customer Category	Approximate # of Customers, this Category
hospitals	800
clinics	500
surgery centers	200
nursing homes	100
NH Provider (?)	50
Home Health	100
HMO	200
Others	100
Total	2050

WEST LAFAYETTE LEVEE PROJECT: TO BUY OR NOT TO BUY? – THAT IS THE QUESTION

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CASE DESCRIPTION

This case focuses on the need for strategic plan and decision to be made on the part of the West Lafayette City Government. The West Lafayette City Council has voted against the purchase of the property while the West Lafayette Redevelopment Commission recommends purchasing the property for development by the city. Key issues include the use of taxpayers monies for the speculative business venture by the city in the development of the property. What should be the decision criteria? What would be a fair purchase price? How should citizen input be obtained? What should be the selection criteria by the city for selection of a developer? This case is based on field research gather from community residents and city government officials as well as material gathered from the local newspaper, television, council and city commissioner meeting minutes. This case would be appropriate for use in undergraduate courses in Business Strategy, Community Planning, and Government.

CASE SYNOPSIS

Sears decided to relocate from its Levee location to the newly renovated Tippecanoe Mall on the south side of Lafayette where it would become one of the anchor stores. Sears is wanting to sell the 116,000 square foot building which has now been vacant for over a year. Since that time, the building has been vacant and has fallen into disrepair. Negotiations between Sears and the City of West Lafayette to purchase the vacant property have been ongoing for a year without any success. Sears has also been in negotiations with various development companies; however, no decision has been made. Local citizens are voicing some concerns about the property. The deterioration of the building and the property is creating an eyesore as travelers first enter the city from the east. Is it time for the City to step forward and take a leadership role in this issue? What should the city's leadership role be? To what level of financial involvement should the city commit?

ABSTRACT

Nearly everyone agrees that something wonderful should be developed at the former Sears property on the levee in West Lafayette. There are dozens of ideas about what should be build there, ranging from a commercial retail/entertainment development to youth center to combined library/arts complex. The West Lafayette City Council has voted against the purchase of the Sears property. However, the Redevelopment Commission has taken a position to purchase the property.

Clearly, it would have been better if West Lafayette had a clearer vision for the levee. The clock is ticking.

LOCATION

The property is located in West Lafayette. West Lafayette is a city of 25,000 people located 60 miles northwest of Indianapolis and 120 miles southeast of Chicago. West Lafayette and Lafayette, a city of 45,000, together form the Greater Lafayette community. Greater Lafayette is known for its central location, strong local economy, educated and skilled workforce, quality of life, low crime rate and enthusiastic support of industrial and business development. The property is located adjacent to State Road 26 which is a major connector route between West Lafayette and Lafayette and State Road 43 which connects West Lafayette to Interstate 65. The property also has a pedestrian walkway over the Wabash River that connects downtown Lafayette to the Levee area and serves a gateway to the West Lafayette community. The Levee area is also a short walk from Purdue University that has 36,000 students and 12,000 employees. With the university comes many attractions such a football games with 55,000 fans attending, basketball games with over 14,000 in attendance, concerts, conferences occurring year round, the bug bowl attracting over 35,000 participants, and numerous other university and student activities. This area also connects the city with the Wabash Heritage Trail, the John T. Myers Pedestrian Bridge and the James Riehle Depot Plaza on the East Side of the Wabash River. The population of Tippecanoe County in which West Lafayette is located is 138,000, excluding the students at Purdue University. See Appendixes D and E.

The Levee also benefits from activities in the Riehle Plaza area on the opposite side of the Wabash River in Lafayette. The Plaza area is a major attraction for summer events such as concerts featuring a variety of musical groups from modern rock to country to classic rock such as the Coasters and the Drifters. The Plaza also hosts art shows, car shows, food feast, and family nights. The Levee is also on the local bus routes and is close to the train station in Riehle Plaza. The Levee is also located between two of the area’s most prestigious historical sites, the Tippecanoe Battleground and Fort Quiatenon. The Tippecanoe Battle field was the site of William Henry Harrison’s victory over the Indians led by the Prophet and draws people from throughout the United States especially on celebration weekends. Fort Quiatenon was the site of an early French settlement which draws people year round and over 65,000 on The Feast of the Hunter’s Moon weekend.

INTRODUCTION

In November 1995, Sears decided to relocate from its Levee location to the newly renovated Tippecanoe Mall on the south side of Lafayette where it would be one of the anchor stores. Sears is wanting to sell the 116,000 square foot building which has been vacant for almost a year. Since that time the building has been vacant and has fallen into disrepair. Estimates show it will cost over $225,000 on roof repairs alone to put the building in leasable condition. Also during this time, the city of West Lafayette has been haggling among themselves whether it should purchase this seven-acre property. The city of West Lafayette spent $33,500 for Level I and II Environmental Assessments, $15,000 in Consulting, and $7,900 in Consulting Engineering to evaluate the site, determine what

minimally needs to be done and how it could best be used. All this with no guarantee at the time that they would become the owners of the Levee's keystone property.

The study found no significant contamination on the site. A geotechnical study of the property found the land could support just about any type of development desired. The only contamination discovered was from heating oil and waste oil tanks that were stored under the property and these were removed at a cost of just a few thousand dollars. The West Lafayette Board of Works also has contracted with Tecton Construction for $7900 to evaluate the site, determine what minimally needs to be done and how it could be best used. Demolition of the 116,000 square foot building is estimated to cost about $300,000, but other costs relating to asbestos abatement are unknown. (Higgins, 1997) Vacancies, deteriorating buildings, and underdevelopment of what would normally be valuable riverfront property typify the general appearance of the Level area.

Negotiations between Sears and the City of West Lafayette to purchase the vacant property have been ongoing for a year. Attempts to buy time through options to purchase were unsuccessful. In Sears' hurried efforts to sell the property to the first viable offer, the City of West Lafayette grew increasing concerned over the value of proposed development ideas. Local citizens began to voice some of the same concerns. Since moving from their State Street location, Sears has had several offers from private developers, some more serious that others. In the end, deals that private developers tried to build fell through. Is it time for the City to step forward and take a leadership role?

Across the river, Lafayette has recently developed it river front area and the adjacent downtown area to once again attract people to the area. As part of a 25-year railroad relocation project, new access between the two cities has become easier with the addition of two new vehicular bridges. The old Main Street bridge has been reworked and made into a pedestrian bridge connecting Lafayette with the West Lafayette Levee area, Tapawingo Park, and the Sears' property.

IDENTIFYING THE PROBLEM

With the property becoming available, should the city of West Lafayette try to purchase the property? The present West Lafayette City Council voted against the purchase of the Sears property; however, the final approval to purchase must come from the West Lafayette Redevelopment Commission. The Redevelopment commission is now authorized to purchase the Sears property for $1,650,000. Several meetings involving the citizens of West Lafayette indicates a majority of the citizens wanted the city to make the purchase and develop the property. Some note this is "a quality of life issue." "It's just really ugly and I'm sick of looking at it," complained some. (Rahner, 1997) However, some citizens and council members worried that the project could run far in excess of the proposed $1.65 million, and they wanted the city to stay out of the speculation business and let developers worry about the property. City Commissioner James Fenn said, "I strongly believe that free enterprise should be the one to develop the site and not the city of West Lafayette. While the intentions of the city are good, it is not their place to determine who shall have the right to build on this land." (Showalter, 1997) Some cite the example of the county's investment in the Tippecanoe County Amphitheater over six years ago and it has yet to pay for itself and may never. Jim McCallister noted, "It's easy to imagine exciting things to do when you're spending other people's money." (Rahner, 1997) Steve Lovejoy, a Purdue University agricultural economics professor,

called the idea of the purchase 'ludicrous' outside the context of the free market. "How," he asked, "could West Lafayette purchase the property and then successfully market it to developers when Sears and Roebuck -- one of America's most successful marketers -- couldn't even do it?" (Rahner, 1997)

Other considerations and concerns have been expressed in the area of development. Demolition is estimated to cost around $250,000 to $300,000. (Redevelopment Meeting Minutes, 1996) This would be grinding up the building and dumping it in the basement. This would fill up about half of the basement. It has not been tested for asbestos, but the ceiling tile and possibly the floor tile will have asbestos present. The estimated cost for this removal would be $300,000 to $350,000, maybe even $400,000. If it cost the city $1.65 million to purchase the site, $600,000 to tear it down and to take care of the asbestos, and hopefully it would not cost any more than $100,000 to do other remediation, bringing the total to $2.35 million for this property. There are seven acres there which would work out to about $335,000 an acre or $7.15 per square foot.

Backing for the Redevelopment Commission's recommendation to purchase has been impressive. The majority of the citizens attending commission meetings are in support of the commission. Realtors, bankers, Chamber of Commerce members, art groups, business owners and Purdue and West Lafayette High School students have all favored the purchase as the best means for the community to guide the redevelopment of the Levee and improve the quality of life along the Wabash riverfront. (Margerum, 1997) Last spring, over 100 members of the Strategic Planning Forum approved the Levee/Sears redevelopment as a major action item. Twenty community groups have also endorsed this concept. Regardless of position or argument, one common view is shared by all – the Levee is an eyesore and it needs some ownership and renovation.

Other findings noted that the soil is river bottom and trying to put a six or eight story building there could create some foundation problems. The present foundation would support a single story structure provided the demolition was done properly. (Glon, 1996)

How far should the local government intervene in private development to see that key areas become nice places? Another citizen noted that there are several other vacant buildings in the city and wanted to know if the city was planning to buy them. The same individual asked, "What other kinds of things will we be asked to fund with our dollars?" (Rahner, 1997)

A STRATEGY FOR THE CITY OF WEST LAFAYETTE

In considering a strategy for the City, the Steering Committee, Task Forces, and Advisory Committee established the following strategies as part of the 1987 Strategic Plan. In 1988 an Urban Design Plan for the City of West Lafayette was completed following the recommendation, "That physical identify and vitality be fostered by systematic, high quality, scheduled development for the Levee and Village."

The strategy should pursue quality. While West Lafayette will grow in numbers, emphasis should be given to high standards in urban design, construction, city services, appearance, etc.

The strategy should preserve and improve livability. This calls for vitality in residential neighborhoods and a balance between preservations and new housing construction.

The strategy should pursue a sense of physical identity. Focal parts of the city where people congregate should foster a sense of place by attractive design, hospitable public space, and public amenities such as art and sculpture.

The strategy should foster expanded private participation in City development. This should take several forms: Greater business input in City planning and marketing; negotiation with developers over quality development goals; and private investment or joint ventures with City Hall.

The strategy should build upon a richness in social character. West Lafayette should continue to be a blend of small-town lifestyle, cosmopolitan atmosphere, and varied cultural amenities and programs.

The strategy should recognize the inevitability of change. Community-wide planning should be participative, anticipative, creative, and long-range.

SUMMARY

In the complex relationships between the government, businesses and the citizens, a decision is needed that will weigh proper consideration for each faction. So, the debate over the Sears building and property redevelopment continues. Although the West Lafayette Redevelopment Commission has adopted a resolution to make an offer to purchase, negotiations continue to ensure all parties involved concerns are met before the city signs any agreement. What may be several acceptable outcomes? What would be you best informed decision?

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APPENDIX A
ESTIMATED PROJECT COSTS AND FUNDING
Assuming Interim financing
(Per City Officials)

	Projected Costs
Acquisition of Sears Building	$1,650,000
Allowance for asbestos removal	140,000
Allowance for soil removal	20,000
Allowance for property taxes	50,000
Demolition	400,000
Sub totals	$2,260,000
Issuance costs	100,000
Underwriting discount 0.50%	8,500
Rounding / contingencies	27,230
Total estimated project costs	$2,395,730
Estimated Project Funding	
Bond anticipation notes	$1,700,000
Available funds on hand	567,000
Estimated December, 1997 TIF distribution	128,730
Total estimated project funding	$2,395,730

APPENDIX B
WEST LAFAYETTE (INDIANA) REDEVELOPMENT COMMISSION

SUMMARY OF PROPOSALS FOR BOND ANTICIPATION NOTES
RECEIVED NOVEMBER 7, 1997

Bidder	Robert W. Baird & Co.	Lafayette Bank & Trust Co.	Citizens National Bank	NatCity Investments
Interest rate	8.00%	7.00%	7.50%	6.60%
Placement fee	$5,000.00	$0.00	$0.00	$6499.00
Interest to February 1, 2001	$332,511.11	$290,947.22	$311,729.17	$247,321.67
Total interest to maturity	$337,511.11	$290,947.22	$311,729.17	$280,820.67
Interest to August 1, 1998	$72,511.11	$63,447.22	$67,979.17	$59,821.67
Total interest to first call	$77,511,11	$63,447.22	$67,979.17	$66,320.67

APPENDIX C
SOCIOECONOMIC DATA

The following provides statistical evidence of the West Lafayette area's socioeconomic conditions.

1. Annual Unemployment Rate

	1992	1994	1997	1998
Tippecanoe County	3.6%	3.4%	2.3%	2.2%
State of Indiana			3.5%	2.9%

Source: Labor market information - IN Department of Workforce Development

2. Population Growth or Decline

	1980	1990	% Change	1997	% Change	2002 Projection	% Change
Project Area	8,442	11,390	34.92% +	13,327	17.01% +	14,966	12.29% +
West Lafayette	21,247	25,907	21.93% +	27,766	7.18% +	31,795	14.51% +
Lafayette	43,011	43,764	1.75% +	44.651	2.03% +	45,972	1.41% +
Tippecanoe County	121,702	130,598	7.31% +	137,980	5.65% +	146,327	6.05% +

Source: 1980 & 1990 Census
Source: Pop-Facts: Demographic Trend Report, Census 90, Updates and Projections by Equifax National Decision Systems

3. Net Assessed Value by Area

	1990	1994	% Change	1997	% Change
Project Area	$15,323,815	$17,670.610	15.31%+	$19,540,870	10.58% +

Source: Tippecanoe County Assessor/s Office

4. Median Household Income by Area

	1980	1990	% Change	1997	% Change	2002 Projection	% Change
Project Area	$8,253	$13,851	61.77% +				
West Lafayette	$14,442	$22,593	56.44% +	$30,168	33.53% +	$38,504	27.63% +
Lafayette		$27,200		$31,603	16.19% +	$37,769	19.51% +

Source: 1980 & 1990 Census
Source: Pop-Facts: Demographic Trend Report, Census 90, Updates and Projections by Equifax National Decision Systems

5. Average Household Income by Area

		1990	1997	% Change	2002 Projection	% Change
West Lafayette		$35,268	$51,478	45.96% +	$65,563	27.63% +
Lafayette		$32,539	$42,441	30.43% +	$55,983	31.91% +

Source: 1980 & 1990 Census
Source: Pop-Facts: Demographic Trend Report, Census 90, Updates and Projections by Equifax National Decision Systems

5. Median Housing Value by Area*

	1980	1990	% Change	1997	% Change
Project Area	$48,000	$70,250	46.35%+		
West Lafayette	$67,400	$94,900	40.80%+	$97,997	3.26% +
Lafayette				$55,672	
Tippecanoe County				$64,800	

Source: 1980 & 1990 Census -- * Single family owner occupied housing only

Source: Pop-Facts: Demographic Trend Report, Census 90, Updates and Projections by Equifax National Decision Systems

KING OF THE BOARD, INC.

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KOB CONCEPT

King of the Board, Inc. wants to get into the business of delivering board game entertainment to adolescents and young adults. The company plans to design, manufacture, market, and distribute a snowboard board game to snow sports equipment retailers for resale through traditional channels and directly to consumers over the Internet.

The venture's founders, Matt Kimball and Bob Oaks, want the game to achieve core board game status with the X and boomlet generations. They feel that the fundamental soundness of the game provides numerous product/market development opportunities. They have conducted initial market research with a prototype of the game on college students. These market tests were very encouraging in the young adult market. The research indicated that snow boarders are also heavy board game players and purchase board games at twice the rate of non-snow boarders. However, they have not tested the game on younger age groups. Although the game offers entertainment and social opportunities, they are concerned that current family and computer game trends run counter to the venture concept. They are not sure if the concept of the game is strong enough to overcome current social and computer game trends.

The game, which was developed by Bob Oaks, will compete with "thinking" board games that have tactical and strategic elements in their play. Direct board game competition is chess, checkers, the triangle game, backgammon, Mancala, Monopoly, Stratego, and Risk. Out manuvering your opponent is a primary objective in all of these games. Bob thinks that a weakness of these games is the predictability of the game play. For example, winning strategies for chess revolve around your level of expertise while winning at Monopoly generally involves acquisition of high rent properties. One exception is Risk, which combines elements of luck and skill similar to King of the Board.

Consultant Matt Kimball developed the market penetration strategy. Matt plans on marketing the game directly to snow sport shops and over the Internet. Distribution through retailers is designed to sell games through traditional retail channels and to promote the game in order to generate direct sales over the Internet. Matt has not forecasted substantial direct sales over the Internet until the second year of operations, after market acceptance is achieved through snow board equipment shops. Wholesale price to retailers is planned at $10.00. This price allows retailers the traditional 100% markup for a suggested retail price is $19.95. Direct sales over the Internet will also be priced at $19.95, plus shipping costs.

THE OPPORTUNITY

The growing popularity of snow boarding provides a number of new product opportunities. King of the Board will sell a leisure/accessory product to snowboarders. No board game is marketed directly to snowboarders at this time. A number of online and Windows 95 based strategy games are

targeted at this market. King of the Board's concept is contrary to the high growth computer games trend. The strategy is to capitalize on the "high touch" backlash to "high tech." Bob and Matt hope the product will appeal to snow sport retailers because it provides additional product offerings. Retailers need to keep their product offerings fresh. Once the snowboard is sold, only apparel allows significant opportunity for repeat sales. King of the Board offers additional revenue opportunities for snow sport retailers.

Toy and game industry research shows that the industry is very concentrated and not very innovative. Although the large toy and game companies are not very innovative, they do rely on large marketing budgets to compete. They have repackaged "Barbie and Ken" and "GI Joe" in almost every manner possible. Bob feels that these companies are essentially ignoring the game board market, in favor of high growth computer games and joint marketing of movie characters. It has been innovative independent companies that have produced product hits in recent years. Tyco developed the tremendously popular Beanie Babies and a Japanese firm developed the Teenage Mutant Ninja Turtles. The last game board to achieve core product status, Trivial Pursuit, was also developed by an independent firm. There have been no core product "hits" in the board game market since Trivial Pursuit in the early 80's.

PRODUCT DESCRIPTION

The core product of the venture is 'King of the Board: The Snow Board Edition.' The rules of the game resemble an ancient version of Chinese chess, but with major modifications. There are thirty-two plastic characters, a plastic game board, game instructions and a nylon carrying case. There are seven snow board characters ranked in a descending power structure similar to western chess. Some characters have more mobility on the game board than others. The object of the game is to take opposing characters to the point that the opponent cannot win the game. Game setup begins by randomly placing all characters face down on the game board. This random setup brings a large amount of luck into play. Play begins by turning a character face up on the game board. Play continues with players taking turns either placing a character face up, moving a character one space at a time, or taking an opponent's character.

THE TOY AND GAME INUDSTRY

The Toy and Game industry is an oligopoly. The top five firms control 67.6% of the market, with $6.55 billion of the industry's $9.7 billion sales in 1995. Company sales, market share, and international sales are shown in Table 1. The industry is currently in a consolidation phase with a number of successful and unsuccessful mergers. Hasbro successfully bought Tyco (Beanie Babies) in 1997. A merger between Mattel and Hasbro fell through in 1997 over Justice Department warnings that they would likely challenge the merger. In Japan, a Sega-Bandai merger was called off due to cultural differences between the two management teams and corporate cultures. Five critical aspects affect the competitive position of industry firms. They are:

1) Product positioning
2) Production and distribution resources to support growth
3) Financing of growth

4) Brand recognition
5) Product development

Table 1
Industry Market Share and Sales

Company	Market Share	Sales	% International Sales/(Size)
Hasbro	27.50%	$2.67B	40%
Mattel	21.10%	$2.05B	37%
Tyco	7.80%	$0.75B	
Fisher-Price	7.70%	$0.75B	
Milton Bradley	3.50%	$0.35B	
Next 11 Firms	18.40%	$1.785B	($315M-$100M)
Next 60 Firms	14.20%	$1.378B	($96M-$5M)

Competition for shelf space is very intense for games and toys due to the limited number of powerful retailers. Mass merchandisers include WalMart, ToysRUs, K-Mart and Target. The large retailers rely on factory sales forces and independent representatives to inform them of new products. Another retail outlet is specialty stores. King of the Board plans to avoid shelf space competition by marketing the game directly to snow sport retail shops and direct sales over the Internet.

TOY AND GAME COMPETITION

Meaningful statistics on the number of games sold, revenue and profitability by board game is not available. Details for Parker-Brothers, a division of Hasbro, are buried in corporate financial statements. Milton-Bradley is an independent company but does not publish or make unit sales available. Future opportunities are projected in movie characters, plush toys and video games. These categories are forecasted to grow 20% a year.

Core products provide consistency in sales and earnings growth. (Barbie, GI Joe, Disney, Fisher-Price, Monopoly, Tonka, and Playskool). They accounted for 87% of Mattel's gross sales in 1996. The main goal for top firms is to establish movie, plush toys and video games as core products to secure future stability in revenue and earnings.

Some fad products have become core products. Recent product fads that have turned into core product lines are Super Soaker, Ninja Turtles, Barney, Troll Dolls, and Beanie Babies. Other fad products, such as pet rocks and giga pets did not enjoy long shelf lives.

The competitive strengths of the big "four" appear over whelming to Bob and Matt. The big "four" have multi-million dollar advertising budgets, established productive resources, multi-million dollar R&D budgets, economies of scale production costs, mature market channels and their products enjoy powerful brand equity. After decades of being given as gifts during holidays, Monopoly and other games are stashed in the closets of almost every household. These products have achieved core product status that provide the "big four" predictable and significant revenue and profit streams.

BOARD GAME TRENDS

1) Average growth rate of from 1987-1996 of 5.2%
2) High growth years 1991 (15.4%) and 1992 (12.2%)
3) Video game decline in 1994-5: 21% growth in 1996
4) Toy industry growth by category (1995 to 1997):

Action fig's (70.7%)	Plush toys (62.4%)	Videos (62.1%)
Vehicles (31.2%).	Educat'l toys (5.4%)	Dolls (1.3%)
Activity toys (-1%)	Ride-Ons (-7.8%)	<u>Games/Puzzles 3.3%</u>

THE SNOWBOARD INDUSTRY

Future sales of snowboards will depend on the ability of manufacturers to differentiate their products and maintain strong distribution channels. The larger manufacturers, Burton, K2, Ride and Morrow command fifty-five percent of the snowboard equipment market. The remaining forty-five percent is split between a number of small companies. Market share growth for large firms is anticipated to come at the expense of the smaller companies as the industry enters into the shakeout stage of the product life cycle.

SNOWBOARD TRENDS

- Industry is eighteen years from the growth apex
- 72 million members of the boomlet generation (ages 4-21)
- 66 million members of Generation X
- Eighty-one percent of snowboarders are under 24
- Males make up 72% of snowboarders
- Female snowboarders continue to grow
- Riders tripled from 1.2 million in 1992 to 3.9 million in 1997
- Compounded growth rate of 30% from 1992 to 1997 is expected to continue in the near future
- 1997-98 will be shakeout years (2.3 million boards produced, only 1.7 million were sold in 1996)

GEOGRAPHIC MARKETS

Worldwide, there are eight million snowboarders. Fifty percent of snowboarders reside in the U.S. The largest concentration of snowboarders is in California, Oregon and Washington. Mountains states (Colorado, Utah, Idaho and Nevada) also have high populations of snowboarders. The other fifty percent of snowboarders reside in Japan and Europe. These two markets have large population centers near snow resort areas.

The target market that King of the Board plans to sell the game to is males and females between the ages of ten and twenty-five. Market development calls for selling in the mountain states

(Colorado, Utah, Idaho), pacific northwest states (California, Oregon, Washington) and Texas in the first year. A total of sixteen million people between ten and twenty-five reside in this geographic market. There are 7,000,000 inCalifornia, 1,700,000 in Washington and Oregon, 5,600,000 in Texas and 1,500,000 million in Colorado, Utah and Idaho. Bob and Matt have assumed that these states contain 2,000,000 snowboarders.

Geographic expansion is planned in year two by marketing the game in the upper mid west and the northeast where the remaining two million U.S. snowboarders reside. Geographic growth in the third year is planned by distributing the game in Europe and Japan. Each planned geographic expansion doubles market size and sales over the preceding year. Table 2 shows King of the Board's plan to double sales for the first three years and then grow twenty-five percent per year for the next two years.

Table 2
Five Year Sales Plan

Geographic Coverage	Rocky Mtns.	Midwest/ Northeast	Japan/ Europe	Olympics	Global
Unit Sales	Year 1	Year 2	Year 3	Year 4	Year 5
Retail Unit Sales	37,900	36,960	73,920	92,400	115,500
Internet Unit Sales	15,100	75,040	150,080	187,060	233,825
Total	53,030	112,000	224,000	279,460	349,325
Dollar Sales	Year 1	Year 2	Year 3	Year 4	Year 5
Retail Unit Sales ($10.00)	$379,000	$369,600	$739,200	$924,000	$1,155,000
Internet Unit Sales (19.95)	$301,245	$1,497,048	$2,994,096	$3,731,847	$4,664,808
Total	$680,245	$1,866,648	$3,733,296	$4,655,847	$5,819,808

PRODUCT DEVELOPMENT

King of the Board plans to develop new products to sustain revenue and profit growth after the fifth year. Matt and Bob believe that new themes can be marketed to different market segments within the X and boomlet generations as well as other revenue generating opportunities.

- **Package and sell single player games that can be attached to the two-player game. This increases the social aspect of game play to include more players.**
- **Develop themes targeted to new market segments. For example, military, geographic, automotive or industrial themes.**
- **A graphic and sound rich online game can also be developed.**
- **Revenue can be generated through online game play fees and by selling website advertising space to the snow sports industry. Potential advertising clients are equipment manufacturers, apparel manufacturers, ski resorts and retailers.**

- **Develop an educational product that combines game play with educational subjects to facilitate learning.**
- **The game could be sold to companies for promotion and advertising. For example, the Nike slash could be printed on the back of game pieces and the board to promote Nike.**

KING OF THE BOARD'S BUSINESS MODEL

The game's inventor, Bob Oaks, contacted consultant Matt Kimball to help define the business, research the industry and develop the idea further so that a business plan could be written and financing arranged. Matt brought a work sheet that contained two scenarios estimating the start up, direct and operating costs of the venture. The first was a "buy" scenario (Table 3) where KOB would buy the majority of venture requirements from vendors. The other extreme was a "make" scenario (Table 4) where KOB would perform the majority of tasks in house.

Table 3
Buy Scenario

Start Up Costs		Variable Costs	
Game Mold	$20,000	Plastic Game Parts	$3.60 per game
Carrying Case Design	$2,000	Carrying Case	$1.50 per game
Website Development	$5,000	Game Instructions	$0.20 per game
Brochure Design	$10,000	Assembly and Packing	$1.00 per game
Promotion Firm	$15,000	Mfg. Representative	$1.40 per game*
Advertising Firm	$15,000	Direct Costs Per Game	$7.70 per game
Personal Computer	$3,000		
Start Up Costs	$65,000		

SG & A	Year 1	Year 2	Year 3
Bookkeeper Salary	$25,000	$28,000	$35,000
Office Expenses	$12,000	$25,000	$50,000
Advertising Costs	$50,000	$100,000	$200,000
Game R& D	0	$100,000	$150,000
SG & A Total	$97,000	$253,000	$335,000

Table 4
Make Scenario

Start Up Costs		Variable Costs	
Game Mold	$10,000	Plastic Game Parts	$2.50 per game
Carrying Case Equipment	$20,000	Carrying Case	$0.50 per game
Website Software	$500	Game Instructions	$0.10 per game
Printer for Instructions	$1,000	Assembly and Packing	$0.50 per game
Assmb'y/Ship Equipment	$5,000	Direct Costs Per Game	$3.60 per game
Personal Computer	$3,000		
Modling Machine	$75,000		
Brochure Design & Cost	$5,500		
Start Up Costs	$120,000		

SG & A	Year 1	Year 2	Year 3
Space for Printer	$2,400	$2,400	$2,400
Selling Trips	$10,000	$40,000	$60,000
Manufacturing Space	$12,000	$24,000	$36,000
Assmb'y/Shipping Space	$6,000	$12,000	$18,000
Website Fees	$1,200	$2,500	$4,000
Advertising Costs	$50,000	$100,000	$200,000
R & D	$0	$100,000	$150,000
SG & A Total	$81,600	$280,900	$470,400

HOW TO PROCEED

Bob and Matt knew that a lot of work must be done before the King of the Board ever hit the store shelves. Bob is a former ski champion and understands the snow sports industry but does not have extensive business experience. Matt on the other hand has helped start a number of businesses in various ways. In addition to operating a sole-proprietorship out of college, Matt also has extensive corporate experience in operations, manufacturing, accounting/finance and dealing with subcontractors. They have a large network of friends that can lend further expertise to the venture but none of this experience is in the game board industry. They had not even considered approaching investors with their business plan for the $200,000 needed, in addition to the $50,000 they had in savings and from family sources. They felt comfortable with the cost numbers after numerous discussions with plastic and packaging companies and toy manufacturers. Yet their market numbers were based on a number of assumptions they were uncomfortable with. They had not finalized the design of the game because they had not tested it on all target market age groups. They had tested a version of the game on college students and had received positive feedback about the concept of the game. But without a final prototype to test they knew the $19.95 price was just an educated guess. They were also uncertain whether the promise of Internet sales would materialize, or if

$50,000 in advertising the first year will be sufficient enough to reach their customers. The final uncertainty was that they have yet to approach snow sport retailers to see if they will even stock the game in their stores.

CASE QUESTIONS

1. Generate a profit and loss statement for the first three years of the venture under the buy scenario.
2. Generate a profit and loss statement for the first three years of the venture under the make scenario.
3. Calculate the 1) fixed cost and 2) fixed cost plus semi-variable cost breakeven points for King of the Board's buy scenario.
4. Calculate the 1) fixed cost and 2) fixed cost plus semi-variable cost breakeven points for King of the Board's make scenario.
5. Identify the assumptions that Matt and Bob have made which could substantially affect the profitability of the venture. Challenge these assumptions and perform a new fixed cost plus semivariable cost breakeven analysis based on your challenges.
6. Evaluate the opportunity that these two entrepreneurs have identified.

SMITH & WESSON TAKES FIRE WHILE MARKETING HANDGUNS TO WOMEN

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INTRODUCTION

Smith & Wesson entered the American handgun market in 1857 when they began selling the first commercially available revolver to chamber a metallic cartridge. While its .22 rimfire cartridge would be rather weak, subsequent models would chamber considerably larger, more powerful cartridges and gain widespread distribution, particularly in the West.[1] Smith & Wesson would become a leading supplier of handguns of all types for the next 141 years. The company would become a primary supplier of handguns to police, the military, and to the civilian marketplace. By 1998 the Smith & Wesson had expanded its product lines to include thirty revolver models and thirty-two pistol models, many with two or more variations.[2] In addition, Smith & Wesson provided custom gunsmithing services, firearms training, apparel, products for police (including bicycles and handcuffs), and specialty metalworking services. (All major product lines are depicted on the company's website.[3]) Handguns for the civilian market, however, remained the company's mainstay.

BACKGROUND

The civilian market for handguns had evidenced little growth for 25 years, with between 1,500,000 and 2,000,000 handguns produced and sold each year.[4] During that period there had been, however, two surges in volume. The first surge ended in with production peaking in 1981 at 2,656,965 handguns. The second ended in 1994 with 2,824,809 produced. A significant shift in the type of handgun demanded also occurred. Revolvers represented 72.1 % of production in 1973, but fell to19.6 % by 1994. Pistols had supplanted them as the handgun of choice. Production and sales volumes were echoed by lack of a clear trend in ownership. National surveys of gun ownership data showed no clear trend either up or down since 1958. For 1989 and 1990 they suggested that about 48 % of American households owned a gun of some type, with about 26 % owning a handgun.[5] More recent estimates, while displaying some sampling variability, had not changed appreciably.

Annual gyrations in production had obscured some important developments. The handgun market had traditionally been viewed as breaking down into five important segments: recreational, competition, hunting, self-defense, and police/military. Emergent interests in each category tended to dominate product development and sales. A surge in interest in handgun hunting during the 1970's had, for instance, driven an increase in sales for large caliber, more powerful handguns such as .44 Magnum revolvers and the development of more specialized handguns chambering rifle cartridges. Similarly, the popularity of cowboy action shooting (a new competitive genre) during the 1990's had fueled an explosive rise in sales of 1870's period-piece revolvers and their newly-manufactured replicas. The U.S. Army's adoption of a new 9 MM service pistol in the 1980's had stimulated civilian sales of similar models. Both revolver and pistol sales received a boost during the late 1980's as media reports and concerns about crime encouraged more people to purchase them for self-defense.

Production of pistols chambering typical self-defense cartridges (.380 ACP, 9 MMM, .45 ACP) climbed 276% between 1988 and 1993 in response to sharp growth in demand.[6]

Some of that expansion was attributed to an increase in the number of states that passed non-discretionary concealed weapons carry permit laws. Such laws require state judges to issue a permit to carry a concealed handgun to any citizen who is not legally barred from owning a handgun (such as convicted felons). Thirty states had passed such laws by 1996. Eighteen states passed them in 1995 and 1996 alone.[7] Thirty-three had done so by 1998, and another five legislatures were considering them. Heavily populated states such as New York and Illinois had not passed such statutes, however. Moreover, a number of major cities, notably Washington D.C., still made it extremely difficult for civilians to carry a concealed handgun or made handgun ownership illegal.

Another impetus to the pistol sales growth experienced during the 1990's was the passage of the 1994 Omnibus Crime Bill, which most recognize as the assault weapons act. That bill, beyond banning the sale of certain types of rifles, reduced the maximum allowable capacity for all newly produced magazines to 10 shots. Pistols chambering the 9 MM cartridge had become popular in part because of the U.S. Army's adoption of the cartridge, but mainly because of their high capacity (16 shots or more) magazines. Production and sales soared from 353,941 to 752,801 between 1992 and 1994 in anticipation of the law's passage.

THE CHALLENGE AND RESPONSE

Hard times, however, ensued. In 1995 it became evident that handgun sales were in sharp decline. By 1996 sales had fallen to a little over half of their 1994 peak. Smith & Wesson, like its competitors, was hit hard. At a time when new gun sales had become very price sensitive, it had also to deal with a low-price competitor. Taurus Mfg. of Brazil, which had become a major player in the American market, was gaining popularity - particularly in revolvers. Taurus produced revolver models that closely copied Smith & Wesson's, but sold them at 30 to 35% lower prices. Taurus had also closed what was once a large quality gap between their revolvers and the comparable Smith & Wesson products.

Smith & Wesson, like all industry participants, worked diligently to find a way through the decline. One approach was to search for segments where demand potential might yet exist. This led the company to develop a focus on women as potential buyers. It had long been observed that women owned and used guns, of all types, at lower rates than men. National surveys reflected this. In 1988 roughly 16% of women reported owning a gun, while 39% of men did so. By 1996 ownership had risen to about 27% of women and 53% of men.[8]

In fact, Smith & Wesson had been the earliest firm to respond to the gender difference in ownership rates. It had begun production of a new model revolver, under the LadySmith line, in 1986. Five revolvers and one pistol were listed in the catalog as LadySmith model variations by 1998. These came with special grips and display cases. LadySmith guns were small, chambered cartridges with adequate power for defensive purposes, and had manageable recoil. Their grips were configured to be more suitable for smaller hands, and trigger pull weights were lightened somewhat. The company was one of the earliest advertisers in a new publication, Women and Guns, first published in 1991. In addition, Smith & Wesson devoted several pages to women on its first website as well

as in its print catalogs. Other companies, such as Lorcin Manufacturing, would follow suit with models intended to appeal to women.

THE CONTROVERSY

None of this was lost on interested observers. Smith & Wesson's, and subsequently others', efforts to target women as first time buyers became embroiled in the more general controversy over personal ownership and use of handguns. A number of organizations such as Handgun Control, the Violence Policy Center, and Physicians for Social Responsibility opposed the ownership and use of handguns as a means of self-defense – whether by women or men. Others such as the National Rifle Association, the Gun Owners Action League, and Women Against Gun Control supported their ownership and their use as a self-defense tool. Interested spectators to the often-heated arguments between proponents and opponents of handguns could quickly become confused. Opponents, while diverse in their arguments, were uniform in asserting that:

- handguns were of little value – in fact, often counterproductive – when used in self defense;
- the presence of handguns escalated the chance of violence in a given situation;
- handguns presented an unacceptable risk of accidental death, particularly among young children;
- handguns contributed to the suicide rate;
- and that there was no constitutionally guaranteed right to ownership or use of handguns;

Proponents demurred vigorously on all these points as well bringing other considerations to bear. Discussions between opponents and proponents often broke down into ad hominem attacks. In fact, some observed that arguments often seemed to have less to do with questions about the instrumental value (or lack thereof) of handgun use than they had to do with broad cultural differences.

Whatever the arguments, companies such as Smith & Wesson did not have the luxury of detachment from the fray. The success of their product lines depended, at least in part, upon how the public policy debate played out. The company's officers had also to consider the opprobrium which vigorous efforts to market handguns to women might produce. Decisions about such efforts would be required soon.

NOTE: One should browse the following websites before answering the questions below. For the arguments opposing handgun ownership or use see http://www.handguncontrol.org and http://www.vpc.org. For arguments favoring handgun ownership or use see http://www.nra.org and http://www.wagc.com. See http://www.amfire.com/afistatistics/menu.html for information from the industry perspective.

1. What is the current state of the handgun market in the United States? What are the implications of this for Smith & Wesson?
2. How attractive is the female market segment for Smith & Wesson?
3. What ethical and public relations issues does Smith & Wesson confront when marketing handguns to women?
4. How should Smith & Wesson resolve those issues?

ENDNOTES

1. Peterson, H.L. (1962). The Treasury of the Gun. Golden Press and Ridge Press, New York, New York. P.216-217.

2. Smith & Wesson (1998). Company Catalog.

3. http://www.smith-wesson.com

4. http://www.amfire.com/afistatistics/production.html

5. Kleck, G. (1991). Point Blank: Guns and Violence in America. Walter de Gruyter, New York.

6. http://www.amfire.com/afistatistics/pistolcaliber.html

7. Lott, J.R. (1998). More Guns, Less Crime: Understanding Crime and Gun Control Laws. University of Chicago Press, Chicago & London. P.86-89.

8. Lott, Op.Cit.

GASTINEAU GOLF

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ABSTRACT

Ned and Nita Nerd are considering either opening or buying an exclusive golf club in Juneau. Neither Nerd knows accounting so they have asked you to help them evaluate this venture. In chatting with Ned you gather the following facts:

1. *New applicants will be considered for membership in January of each year. The membership fee for the club is a one-time payment of $10,000 payable at the time of admittance. Each member must also pay annual dues each January. The amount of dues depends on the type of membership. Golf-only memberships have annual dues of $1000, while tennis and pool membership dues are $800. The one-time membership fees will be used to pay off part of the principal of the mortgage and will not be considered in the club profits and losses used to calculate the manager's salary.*

2. *Ned expects a total of 600 applicants in the first year of operation and 400 in the second year. He estimates that a maximum of 500 members can be accepted if the club is restricted to golf-only memberships and 800 members could be accepted if a combination of golf memberships and pool and tennis memberships are sold. He forecasts maximum membership will be achieved by the beginning of year 2. The marketing firm hired to assist Ned estimates that 60% of applications each year will be interested in golf-only, 40% will be tennis and pool. The members using the club at any given time are expected to be in the same approximate proportions as the types of applications accepted.*

3. *In addition to the membership fees and annual dues, Ned expects to receive revenue from the shop selling golf and tennis supplies as well as from the club dining room and bar. Sales are expected to average $400 per member in year one. The $400 per member is expected to increase by 5% a year for the first 5 years. The cost of merchandise sold and of labor is expected to run 60% of sales.*

4. *Each member is assessed a minimum monthly fee of $100 for the club dining room and bar whether they eat there or not. Ned estimates that 4% of patrons will have monthly bills of $50, 10% will have tabs of $100, 50% will have dining room charges of $200, and 35% will charge meals and drinks of $300 per month. Based on the average mix of drinks and food experienced by other golf courses, Ned expects cost of the food and drink sold will average 60% of the revenue from the meals.*

5. *Members are required to use electric golf carts on the course to speed up play. The carts rent for $20 for 18 holes of golf and can carry two golfers ant their clubs. The club can lease the carts for $250 per cart per month. The leasing company is responsible for all repairs and provides replacement carts if there are breakdowns. Alternatively, the club can buy the carts for $12,000 each. The carts are estimated to have a useful life of 4 years. At any one time, three carts are expected to be out of service for repairs and maintenance. Maintenance is expected to average $200 per cart per year. The company's cost of capital is 10%. Electricity to recharge the carts is expected to be $3 per cart per 18 holes of golf. Golfers are expected to complete 18 holes of golf in four hours or less. No more than seventy-two carts can be on the thirty-six hole course at any one time. The lighted course is open twelve hours a day during the week and sixteen hours a day on weekends. Average utilization of the golf course is expected to be 90% on weekends and 60% during the week.*

6. *Other costs of the club will include personnel. Ned wants to assure good service. He estimates that no more than one third of the persons will be at the club at any one time during the week and no more than eighty per cent will be at the club at any given time on the weekends. Of those at the club he believes no more than 50% will be in the restaurant bar at any given time. He wants to provide one waiter or waitress for every 100 patrons using the club, one lifeguard on duty at all times on the weekdays and two on the weekends. The waiters/waitresses will be paid $8 an hour (including benefits). The lifeguards will receive $10 per hour. The dining room will be open 15 hours a day on the weekends and twelve hours a day during the week. The pool will be open 8 hours a day on the weekdays and 12 hours a day on the weekends. No employee is allowed to work more than 8 hours a day. The two chefs are each paid a salary of $50,000 a year. All wages and lease payments are paid at the end of each month. The golf pro will be paid a salary of $2,000 a month and gets to keep any fees for golf lessons.*

7. *Ned estimates that there will be twelve weeks a year when the weather will keep the golfers from using the course, but he believes the indoor driving range will lure them out to the pro shop and dining room.*

8. *Maintenance costs are estimated to be $30,000 per month for the golf course, $1500 per month for the pool, and $500 per moth for the tennis courts. These are paid in cash as they occur.*

9. *Property taxes on the club are expected to be $50,000 per year, liability insurance another $20,000, and salary to the manager for running the place has been set at $20,000 plus some form of profit sharing. All items except the managers' salaries are paid at the end of the year.*

10. *The golf course, tennis courts, pool and club house will cost $20,000,000 to buy. Ned anticipates paying $500,000 in cash and financing the rest at 8% interest over 30 years. The annual payment will be made at the end of the year. Depreciation expense is estimated to*

be $50,000 per year. If only golf is offered, the purchase price is only $16,000,000 for the course and clubhouse and depreciation would be $40,000 per year.

11. *Gastineau Golf's federal income tax rate is expected to be 30%.*

REQUIRED:

1. *Looking at item #5:*
   a. *Show computations of the net present value, internal rate of return, and payback period for the purchase option.*
   b. *Should the Nerds lease or buy? Use your selection here in the rest of the problem.*
2. *Should the club sell golf-only memberships or a sales mix of the two types of memberships?*
3. *Based on your answers above, prepare a forecasted income statement for years one and two for the club. Any cash needs can be met through short term borrowing at 10%.*
4. *Would you recommend that Ned proceed with this investment? Why or why not?*
5. *Assuming Ned does proceed with this venture, discuss how you think the various business operations should be organized and how the mangers (restaurant/bar, golf course, pool, pro shop, and overall) should be evaluated?*

FINANCIAL INSOLVENCY: THE CASE OF A SMALL COMMUNITY HOSPITAL

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CASE DESCRIPTION

The primary subject matter of this case concerns the financial condition of Newport News General Hospital at the end of an extended period of discontinuous management and financial distress. Secondary issues include managerial stewardship and the need for organizational direction. The case has a difficulty level of three, and is designed to be taught in one class hour. It should require one and a half hours of outside preparation by students.

CASE SYNOPSIS

This case features a small community hospital suffering from a changing social environment, a lack of continuous management and direction, and a number of failed attempts to keep the dream of a community service hospital alive. After nearly three decades of financial calamity, the newly hired manager is tasked with the dubious responsibility of charting direction for the severely ailing hospital. The task presented to students is one of analyzing the financial condition of the firm and assessing alternatives that may be pursued.

THE PAST AND THE PRESENT

Dr. Noland Wright*, newly appointed manager of Newport News General Hospital, sighed as he reviewed the hospital's financial records. He had been given the responsibility of leading the hospital's next steps, but was perplexed by the financial condition highlighted in the financial statements before him.

Newport News General Hospital had initially begun in 1914 as Whittaker Memorial Hospital, a community-run hospital serving the black population of Newport News, Virginia. To meet the needs of an economic expansion of the community largely due to increased commercial activity during World War II, the hospital expanded facilities and scope through federal funding. In the 1940's the hospital increased its census and gained accreditation by the American College of Surgeons. In the 1950's and 60's the hospital enjoyed a bustling business in the segregated health care industry.

With the advent of the desegregation movement in the 1960's, the hospital experienced several threats as black physicians gained the ability to admit patients to the large and better equipped traditionally 'white' hospitals in the area. The civic organization that governed the hospital began to be concerned for the hospital's survival. It was experiencing a falling census, a deteriorating reputation concerning the quality of its health care, and picked up the reputation of being a 'public' hospital (which it was not). While the City of Newport News was willing to help, it was unwilling to

acquire full responsibility for the costs of a public hospital. During the 1970's, the hospital drew on an emergency fund set up by the city.

Throughout the 1970's, the hospital suffered from losses and bad debts. By 1982 the civic board that guided the hospital became inactive. The following year, the last of the segregation practices ended by court order at the large surrounding hospitals. Few patients desired to be admitted to the small, modestly equipped hospital, preferring the large, modern hospitals they now had access to. The hospital ended 1983 with a $402,000 budget deficit. Suppliers began demanding cash payments for purchases. Employee layoffs, tightening of admission criteria, and refusal of non paying patients were some of the steps taken to alleviate the dire financial situation. It was hoped that a new facility, new location and a future change of name to Newport News General Hospital would help the hospital to survive. A $15 million bond issue and $1.5 million in community pledges allowed the hospital to continue to operate. At the end of 1984 the fund deficit was $749,000. Private healthcare management firms were solicited for help, but these efforts were short-lived.

In July 1985, Newport News General Hospital was dedicated, with a new facility and equipment, and a higher occupancy rate. Between 1979 and 1985, seven different administrators had been in charge of the hospital. Continued losses after 1985, and continued difficulty in retaining continuous management, convinced the hospital's supporters to seek some solution to the ongoing problems. Political avenues were tried with some success, but did not last. The sale of the hospital to a doctors' investment group was considered, but the hospital's supporters ultimately rejected the deal.

By 1990 the debt was in excess of $20 million. The 'board' of supporters agreed to file for bankruptcy. The Guarantor of the mortgage, the U.S. Department of Housing and Urban Development, took over the mortgage debt. The hospital continued to operate as the board sought affiliations with other area hospitals. The quality ratings for the hospital continued to suffer. In 1993 the hospital was granted its bankruptcy petition. HUD settled for $4 million, and other creditors were held at bay. Political solutions were sought, and ultimately, did not help the hospital's condition. Administrators were hired, but their tenures were short-lived. By mid 1996 the hospital was again running a large fund deficit and was seeking direction in what appeared to be a rather hopeless situation. The financial statements for Newport News General Hospital appear in Exhibits 1,2, and 3.

NEWPORT NEWS GENERAL HOSPITAL
Income Statement
for the years ended June 30,1994, and June 30,1995

	1994	**1995**
OPERATING REVENUE		
Net Patient Revenue	$ 8,528,383	$ 9,858,446
Other Revenue	386,285	253,563
TOTAL REVENUE	8,914,668	10,112,009

OPERATING EXPENSES		
Salaries	3,355,391	3,540,940
Payroll Taxes	1,026,076	1,274,260
Physician Fees	807,431	787,895
Contracted Services	1,581,970	1,564,821
Medical Supplies	738,677	782,988
General Supplies	165,038	171,957
Utilities	319,613	279,288
Insurance	128,486	163,558
Legal	52,458	66,508
Rental	142,229	119,594
Other	197,854	170,065
Bad Debt	278,389	544,602
TOTAL OPERATING EXPENSES	8,793,612	9,466,476
INCOME (LOSS) BEFORE INTEREST AND DEPREC.	121,056	645,553
NONOPERATING GAINS(LOSSES)		
Interest	(33,544)	(105,325)
Depreciation	(802,490)	(771,492)
Reorganization Cost	(72,458)	0
TOTAL NONOPERATING GAINS(LOSSES)	(908,492)	(876,817)
INCOME(LOSS) BEFORE NONRECURRING BAD-DEBT WRITEOFF	(787,436)	(231,284)
NONRECURRING BAD-DEBT WRITEOFF	0	(439,720)
EXPENSES AND LOSSES IN EXCESS OF REVENUES AND GAINS	$(787,436)	$(671,004)

NEWPORT NEWS GENERAL HOSPITAL
Balance Sheet
June 30,1994, and June 30,1995

	1994	**1995**
ASSETS		
CURRENT ASSETS		
Cash	$ 791,893	$ 577,461
Trade Receivables	1,539,390	2,062,142
Other Receivables	7,847	46,449

Supplies Inventory	271,997	277,191
PrePaid Expenses	85,265	102,066
TOTAL CURRENT ASSETS	2,696,392	3,065,309
PROPERTY, PLANT, AND EQUIPMENT		
Land	276,865	276,864
Buildings	8,772,782	8,772,782
Equipment and Fixtures	5,243,738	5,354,421
TOTAL	14,293,385	14,404,067
accumulated depreciation	6,999,531	7,535,929
P,P,E less accum. deprec.	7,293,854	6,868,138
OTHER ASSETS		
Deposits	87,113	87,113
Unamortized Debt Expense	522,850	522,850
TOTAL OTHER ASSETS	609,963	609,963
TOTAL ASSETS	**10,600,209**	**10,543,410**
LIABILITIES		
CURRENT LIABILITIES		
Accounts Payable	802,184	1,036,151
Notes Payable	0	40,000
Due to 3rd Party Payors	2,924,863	2,840,027
Accrued Payroll	59,569	58,926
Accrued Vacation	192,881	251,500
Other Accrued Expenses	498,133	312,049
TOTAL CURRENT LIABILITIES	4,477,630	4,538,653
LONG TERM LIABILITIES		
Capital Lease	0	29,317
LIABILITIES SUBJECT TO COMPROMISE	21,972,071	21,972,071
FUND DEFICIT	(15,849,492)	(15,996,631)
TOTAL LIABILITIES AND FUND DEFICIT	**10,600,209**	**10,543,410**

NEWPORT NEWS GENERAL HOSPITAL
Statement of Cash Flows
for the years ended June 30,1994, and June 30,1995

	1994	1995
CASH FLOW FROM OPERATING ACTIVITIES AND GAINS AND LOSSES:		
EXPENSES AND LOSSES IN EXCESS OF REVENUES AND GAINS	$ (787,436)	$ (671,004)
ADJUSTMENTS: OPERATING ACTIVITIES		
Depreciation and Amortization	802,490	771,492
Increase in Accounts Receivable	(579,126)	(561,354)
Increase in Inventories	8,819	(5,194)
Increase in Prepaid Expenses	23,016	(16,801)
Increase in Other Assets	(10,000)	0
Increase in Accounts Payable	414,591	233,967
Decrease in Third Party Payable	1,041,761	(84,836)
Decrease in Accrued Expenses	(161,185)	(128,108)
NET CASH PROVIDED FROM OPERATING ACTIVITIES AND GAINS AND LOSSES	752,930	(461,838)
CASH FLOWS FROM INVESTING ACTIVITIES:		
PURCHASE OF PROPERTY AND EQUIPMENT	(154,944)	(55,258)
NET CASH USED BY INVESTING ACTIVITIES	(154,944)	(55,258)
CASH FLOWS FROM FINANCING ACTIVITIES:		
PRINCIPLE PAYMENTS ON CAPITAL LEASE	0	(26,107)
NET BORROWING ON LINE OF CREDIT	0	40,000
NET CASH USED IN FINANCING ACTIVITIES	0	13,893
NET INCREASE IN CASH AND CASH EQUIVALENTS	597,986	(503,203)
PRIOR PERIOD ADJUSTMENT:	0	288,771
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	193,907	791,893
CASH AND CASH EQUIVALENTS AT END OF YEAR	791,893	577,461

NEWPORT NEWS GENERAL HOSPITAL
Statement of Cash Flows
for the years ended June 30,1994, and June 30,1995

FUND SURPLUS (DEFICIT): JULY 1, 1993	$(15,062,056)
EXPENSES AND LOSSES IN EXCESS OF REVENUES AND GAINS	(787,436)
FUND SURPLUS (DEFICIT): JUNE 30, 1994	(15,849,492)
EXPENSES AND LOSSES IN EXCESS OF REVENUES AND GAINS	(671,004)
FUND SURPLUS (DEFICIT): JUNE 30, 1995	**$(15,996,631)**

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Virginia Health Services Cost Review Council.

Special recognition should be given to E. Lee Makamson, who did background research on Newport News General Hospital, and was the principal co-author of a comprehensive strategic version of this case (Hampton University School of Business Working Paper #WP 1997-05, March 13, 1997). This version is adopted from the original working paper.

*Dr. Noland Wright is a fictitional name, and is placed in a fictitional role as the newly hired manager of Newport News General Hospital. No similarity to real persons is implied or intended. Details about the condition of the firm are factual.

QUESTIONS

1. What is the ‘fund deficit’ in the firm’s balance sheet? What account would be its equivalent for a for-profit organization?

2. What is the hospital’s financial condition and its prospects for continued operations?

3. Develop alternatives for Dr. Wright. Which alternative do you think is the best solution?

4. To whom is Dr. Wright responsible? Is there any group or individual that would claim NNGH as its own and take responsibility for it? How does this situation illustrate the need for a principal stakeholder to whom management would be accountable?

5. In the past, the hospital appeared to be on the verge of collapse, with no chance for resurrection, yet continued to operate. Have you considered some creative solutions such as those that may have been tried in the past?

FIRST BANK SYSTEMS - US BANCORP: THE NATURE OF A BANK MERGER

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CASE DESCRIPTION

The primary subject matter of this case concerns the discussion and analysis of a merger between two large regional banks to form a major banking organization spanning from midwest to the Pacific coast. The merger was the fourth largest to that point in time, and a large premium over book value was agreed upon. The case has a difficulty level of four. It is designed to be taught in three class hours and is expected to require six hours of outside preparation by students. Several approaches for using the case for learning will be suggested through pointed questions targeting the foremost features of the deal. The reader is challenged to reach beyond the information presented in the case in order to enhance understanding of the merger and to encourage the development of information search capabilities.

CASE SYNOPSIS

Many characteristics of our modern economy and regulatory environment have come together in the past decade and a half to encourage the combining of financial service enterprises. A wave of bank mergers and acquisitions has resulted, and the wave has little likelihood of ending soon.

Much can be learned from observing the dynamics of an individual merger, especially if information is readily available. One such merger is the marriage of First Bank Systems, headquartered in Minneapolis, MN, and US Bancorp, headquartered in Portland, OR. First Bank Systems paid almost three and a half times US Bancorp's book value, an extremely high bid relative to most bank mergers. The $8.4 billion deal was the fourth largest up to that point in time.

This study will review events leading up to the merger and review the dynamics of the merger in an attempt to provide understanding of the way such mergers can occur at premium prices.

FIRST BANK SYSTEMS PRE-MERGER CONDITION

First Bank Systems, Inc. of Minneapolis, Minnesota is a regional, multi-state bank holding company that offers a considerable number of financial products and services for individuals, businesses, and institutions. First Bank Systems has expanded out of its upper midwest base to establishing representation in eleven states as far west as Colorado and Wyoming.

First Bank Systems is a leader in corporate trust services as well as electronic credit card payment systems. First Bank Systems has the largest share of deposits in North Dakota, and in bigger states such as Minnesota, Colorado, and Nebraska, it's share is second largest.

First Bank Systems is able to effectively serve customers through several distribution channels including 359 banking and non-banking offices, a network of 3,235 automated teller machines (ATMs), and through 24 hour centralized telephone service centers.

First Bank Systems is committed to maximizing shareholder wealth. The bank began streamlining senior management in 1996, and realigned the entire organization into five lines of business. The businesses include:

1) Retail Banking through convenient, cost-effective channels such as supermarkets, ATMs, and 24 hour banking by telephone.
2) Payment Systems, which include corporate cards and merchant processing.
3) Business Banking and Private Financial Services which provides credit and other financial services to middle market companies, and investment services to extremely affluent customers.
4) Commercial Banking includes credit products, treasury management, trust and other financial services, predominantly serving large companies in the midwest region.
5) Corporate Trust and Institutional Financial Services provide custody services to corporations, municipal debt services, 401k's and other employee benefit programs.

First Bank Systems is one of the country's top performing banking companies in terms of profitability and efficiency. One hundred dollars invested in First Bank System's common stock on December 31, 1989 would have been worth $991 on March 31, 1998. That compares with $585 for the KBW 50 bank index and $390 for the S&P 500 stock index.

First Bank Systems has been able to achieve high returns while at the same time maintaining a low risk profile. Another reason for First bank System's continued success is their pledge to benefit employees through employee stock purchase plans. Management in particular is especially interested in maximizing shareholder wealth, because senior managers owned more than $100 million in First Bank Systems stock at the end of 1996. First Bank Systems pre-merger financial statements appear in Exhibit 1.

U.S. BANCORP PRE-MERGER CONDITION

U.S. Bancorp of Portland, Oregon is among the 30 largest bank holding companies in the United States in terms of assets. The principal subsidiaries of U.S. Bancorp as of December 31,1996 includes U.S. National Bank of Oregon, U.S. Bank of Washington, U.S. Bank of Idaho, U.S. Bank of California, U.S. Bank of Nevada, and U.S. Bank of Utah. The subsidiaries of U.S. Bancorp are involved in general retail/corporate banking, investment and trust services, commercial banking, lease financing, discount brokerage, investment advisory services, and credit life insurance services. Moreover, U.S. Bank of Oregon advised a group of mutual funds, the Qualivest Funds. U.S. Bancorp also has the largest share of deposits in Oregon and Idaho.

As of December 31, 1996, U.S. Bancorp and it's subsidiaries have 14,055 full-time employees. A number of benefits programs are available to all eligible employees (including officers) of U.S. Bancorp and subsidiaries.

U.S. Bancorp has made it a priority to continue to consolidate operations & subsidiaries, with ongoing acquisitions to continue effective cost management and achieve operating efficiency while meeting corporate objectives. On December 31, 1996, U.S. Bancorp banking subsidiaries has more than 600 banking offices, and 1300 automated teller machines located in Oregon, Washington, Idaho, Northern California, Nevada, and Utah. U.S. Bancorp also has 24 hour telephone banking, a full service loan center by phone, and a U.S. Bancorp on-line personal computer banking. Loan services offered by U.S. Bancorp's banking subsidiaries include mortgage loans, real property loans, and individual lines of credit, both unsecured and secured.

Because of its large branch network and the rapidly growing economic growth in their service area U.S. Bancorp has long been considered a hot prospect for takeover. It has been the position of U.S. Bancorp chairman and chief executive Gerry B. Cameron if anyone offered more than 3 times the company's book value, they would agree and avoid the risk of a shareholder suit. US Bancorp's pre-merger statements appear in Exhibit 2.

FIRST BANK SYSTEM RATIONALIZATION FOR MERGER

On March 21, 1997 First Bank System Inc., confirmed it would acquire U.S. Bancorp of Portland, Oregon in a stock swap valued at the time to be $8.44 billion (later determined to be $9.98 billion), the fourth largest bank merger of all time as of 1996. First Bank Systems paid a premium of 3.4 times the U.S. Bancorp book value and 17.1 times U.S. Bancorp's estimated 1997 earnings. Surprisingly, analysts agreed that the price was within the range for which high quality banks were selling. First Bank Systems stock traded at more than 3.4 times book value, enabling them to somewhat justify the deal.

The newly created company, which took the U.S. Bancorp name, and uses First Bank System's Minneapolis headquarters, has $70 billion in assets, and 26,630 full-time employees. As in all mega-mergers, however, there were layoffs. Approximately 4,000 positions were estimated to be cut. Fortunately First Bank Systems and U.S. Bancorp don't have overlapping banking branches or geographic territories, so no branches had to be closed as a direct result of the merger. The company combines back office operations and administrative functions, hoping to cut out nearly 30% of the expense base of U.S. Bancorp, or about $340 million annually [7]. While 4,000 jobs will be cut, only half that many may actually occur once retirement, job changes, and attrition are factored in. For those employees whose jobs are being cut, the severance packages available are among the best in the industry. Severance packages in the banking industry typically range from two to four weeks of pay per year of service. Severance pay for U.S. Bancorp employees will be four weeks for each year of service, with minimum nine weeks pay. Some managers are guaranteed a minimum of twelve months severance pay.

Technology played a major role in U.S. Bancorp's decision to be acquired by First Bank Systems. According to analysts, U.S. Bancorp would have had to spend $200 million over the next several years to purchase systems to provide customer and product profitability data [2]. First Bank

Systems, on the other hand, has managed to unwaveringly invest in technology that can accurately track customer satisfaction and profitability.

In 1990 First Bank Systems moved to centralize operations, and though the company is legally organized as seven banks from a technological standpoint it functions as a one-bank company. This has made it easier for First Bank Systems to integrate 23 acquisitions over the past five years. Moreover, the last big bank First Bank Systems acquired, Firstier Financial Inc. of Omaha, was transfigured to First Bank Systems' computer system within two days following the close of the deal.

MARKET REACTION

On August 1, 1997 First Bank Systems closed on its acquisition of Portland based U.S. Bancorp. First Bank Systems agreed to pay .755 shares of stock for each U.S. Bancorp share. First Bank Systems closed Friday August 1, 1997 at $86.94 down $2.06, while U.S. Bancorp closed at $65.41 down $1.34, making the deal worth $9.98 billion.

As far as the structure of the new company's management, two U.S. Bancorp executives would get prominent roles, reporting to the President and Chief Executive Officer John F. Grundhofer. Vice chairman Robert D. Sznewajs would be Vice chairman in charge of retail banking. Gary T. Duim, president of retail banking, would become vice chairman in charge of corporate banking in U.S. Bancorp's region. U.S. Bancorp's current chairman, Gerry B. Cameron, would retain that title until 1998, when he had previously said that he would retire.

AFTERMATH OF THE MERGER

The Minnesota-based Company has become one of the largest corporate trust services by targeting the labor-intensive services (while others are abandoning those services). The firm is a national leader in electronic credit card payment systems, commercial lending, and mortgage financing, direct real estate lending and corporate financing.

This past year U.S. Bancorp surpassed each financial goal they set. U.S. Bancorp earned a record $23.5 million or $4.61 on a diluted per share basis in 1997. The Company's performance reflects a 17.4% earnings increase and a 20.4% increases increase in diluted earnings per share when compared to the $20.0 million or $3.83 per diluted share reported in 1996. U.S. Bancorp's goal to achieve and maintain a 15.00% return on equity was also accomplished in 1997. The significant growth in earnings has led to 121% appreciation in U.S. Bancorp's stock price over a two-year period. The annual total return on U.S. Bancorp common stock over the last five years has averaged 32%. This 32% exceeds S&P 500 Index average annual total return of 20% for the same time period.

QUESTIONS

1. How was the high bid for US Bancorp justified?
2. What was the stock market's reaction to the merger announcement?
3. List as many factors as possible to explain the wave of bank mergers in the 1990's (you should use outside resources). Which of these were apparent for the FBS-USB merger?

4. Using a search in your library or on the internet, summarize the condition of the combined firm today. Does it appear that the merger was good for USB's shareholders? For FBS's shareholders?
5. The FBS-USB merger occurred in a stock market bull run approaching record length. 1998 has presented a much different character for the stock markets. Do you think either firm would have been interested in merging in a bear market? Justify your answer with theory and facts.

EXHIBIT 1a: CONSOLIDATED BALANCE SHEET, First Bank Systems

At December 31 (In Millions, Except Shares)	1996	1995
ASSETS		
Cash and due from banks	$2,413	$1,837
Federal funds sold	$32	$35
Securities purchased under agreements to resell	$795	$230
Trading account securities	$146	$86
Available-for-sale securities	$3,555	$3,256
Loans	$27,128	$26,400
Less allowance for credit losses	$517	$474
Net loans	$26,611	$25,926
Bank premises and equipment	$404	$413
Interest receivable	$202	$197
Customers' liability on acceptances	$169	$223
Other assets	$2,162	$1,671
TOTAL ASSETS	$36,489	$33,874
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing	$7,871	$6,357
Interest-bearing	$16,508	$16,157
TOTAL DEPOSITS	$24,379	$22,514
Federal funds purchased	$1,204	$2,000
Securities sold under agreements to repurchase	$819	$269
Other short-term funds borrowed	$2,074	$2,116
Long-term debt	$3,553	$3,201
Company -obligated mandatorily redeemable capital securities of FBS Capital I	$300	$0
Acceptances outstanding	$169	$223
Other liabilities	$938	$826
TOTAL LIABILITIES	$33,436	$31,149
Shareholders' equity:		
Preferred stock		$103
Common stock, par value $1.25 a share-authorized 200,000,00 shares; issued: 1996-141,747,738 shares; 1995-135,632,324 shares	$177	$170
Capital surplus	$1,154	$909
Retained earnings	$2,165	$1,918
Unrealized gain on securities, net of tax	$3	$23

	1996	1995
Less cost of common stock in treasury: 1996-6,877,497 shares, 1995-8,297,756 shares	-$446	-$398
Total shareholders' equity	$3,053	$2,725
Total liabilities and shareholders' equity	$36,489	$33,874

EXHIBIT 1b: CONSOLIDATED STATEMENT OF INCOME

Year Ended December 31 (In Millions, Except Per-Share Data)	**1996**	**1995**	**1994**
INTEREST INCOME			
Loans	$2,339.3	$2,273.4	$1,914.7
Securities:			
Taxable	$241.5	$226.0	$327.9
Exempt from federal income taxes	$25.5	$11.2	$12.0
Other interest income	$47.6	$34.6	$33.5
Total interest income	$2,653.9	$2,545.2	$2,288.1
INTEREST EXPENSE			
Deposits	$673.1	$706.7	$597.3
Federal funds purchased and repurchase agreements	$122.4	$118.1	$103.1
Other short-term funds borrowed	$120.4	$90.2	$20.4
Long-term debt	$202.7	$190.0	$147.9
Company-obligated mandatorily redeemable capital securities of FBS Capital I	$2.3	$0.0	$0.0
Total interest expense	$1,120.9	$1,105.0	$868.7
Net interest income	$1,533.0	$1,440.2	$1,419.4
Provision for credit losses	$136.0	$115.0	$123.6
Net interest income after provision for credit losses	$1,397.0	$1,325.2	$1,295.8
NONINTEREST INCOME			
Credit card fees	$292.6	$232.7	$179.0
Trust fees	$230.7	$175.3	$159.2
Service charges on deposit accounts	$141.5	$123.7	$127.3
Investment products fees and commissions	$33.4	$27.6	$29.6
Securities gains (losses)	$15.0	$0.0	-$115.0
Termination fee	$190.0	$0.0	$0.0
State income tax refund	$65.0	$0.0	$0.0
Gain on sale of mortgage banking operations	$45.8	$0.0	$0.0
Gain on sale of branches	$0.0	$31.0	$0.0
Other	$171.7	$192.8	$178.8
Total noninterest income	$1,185.7	$783.1	$558.9
NONINTEREST EXPENSE			
Salaries	$465.6	$441.0	$450.7
Employee benefits	$105.0	$96.4	$105.7
Goodwill and other intangible assets	$106.5	$57.1	$50.4
Net occupancy	$98.5	$98.6	$103.8

Furniture and equipment	$89.0	$94.2	$88.3
Other personnel costs	$55.8	$40.9	$35.7
Professional services	$39.9	$36.9	$38.5
Advertising and marketing	$35.4	$32.0	$35.5
FDIC insurance	$11.4	$35.8	$58.4
SAIF special assessment	$51.0	$0.0	$0.0
Merger, integration, and resizing	$69.9	$0.0	$66.2
Merger-related severance	$0.0	$0.0	$56.5
Other	$260.1	$273.0	$259.7
Total noninterest expense	$1,388.1	$1,205.9	$1,349.4
Income from continuing operations before income taxes	$1,194.6	$902.4	$505.3
Applicable income taxes	$454.8	$334.3	$191.8
Income from continuing operations	$739.8	$568.1	$313.5
Loss from discontinued operations	$0.0	$0.0	-$8.5
Net income	$739.8	$568.1	$305.0
Net income applicable to common equity	$733.6	$560.6	$292.4
EARNINGS PER COMMON SHARE			
Average common and common equivalent shares	137,415,619.0	133,936,030.0	136,274,991.0
Income from continuing operations	$5.34	$4.19	$2.21
Loss from discontinued operations	$0.00	$0.00	-$0.06
Net income per share	$5.34	$4.19	$2.15

EXHIBIT 2a. U.S. BANCORP AND SUBSIDIARIES (PRE-MERGER)
CONSOLIDATED BALANCE SHEET
(IN MILLIONS, EXCEPT SHARE DATA)

	DECEMBER 31,	
	1996	**1995**
ASSETS		
Cash and due from banks	2401.1	2416.2
Federal funds sold and security resale agreements	70.9	506.4
Other short-term investments	14.2	10.1
Trading account securities	85.1	279.7
Loans held for sale	180.5	160.5
Securities available for sale, at fair value (amortized cost: 1996--$3,041.7; 1995--$3,259.1)	3047.9	3276.7
Securities held to maturity, at amortized cost (fair value: 1996--$810.9; 1995--$885.7)	796.7	865.1
Loans and lease financing, net of deferred fees	25046.7	22784.8
Allowance for credit losses	-475.9	-434.5
Net loans and lease financing	24570.8	22350.3
Premises, furniture and equipment, net	614.1	633.8
Other real estate and equipment owned	25.1	32.7
Customers' liability on acceptances	327.7	306.7
Goodwill and core deposit intangibles	377.6	190.7

Other assets	748.7	765.4
	33260.4	**31794.3**
LIABILITIES		
Interest-bearing deposits	18503.8	17255.0
Noninterest-bearing deposits	6473.2	6009.7
Total deposits	**24977.0**	**23264.7**
Federal funds purchased and security repurchase agreements	1672.4	2731.1
Commercial paper and other short-term borrowings	822.5	868.2
Long-term debt	1811.5	1377.0
Acceptances outstanding	327.7	306.7
Other liabilities	638.5	629.6
Total liabilities	**30249.6**	**29177.3**
CAPITAL QUALIFYING SECURITIES		
U.S. Bancorp-obligated mandatory redeemable capital securities of subsidiary trust holding only junior subordinated deferrable interest debentures of U.S. Bancorp	300.0	0.0
SHAREHOLDERS' EQUITY		
Preferred stock, authorized 50,000,000 shares:		
Series A, no par value, 6,000,000 shares outstanding	150.0	150.0
Common stock, $5 par value, authorized 250,000,000 shares, outstanding: 1996--147,199,668; 1995--150,592,468	736.0	752.9
Capital surplus	178.1	347.8
Retained earnings	1644.5	1356.9
Net unrealized gain on securities available for sale, net of tax	2.2	9.4
Total shareholders' equity	**2710.8**	**2617.0**
	33260.4	**31794.3**

EXHIBIT 2b. U.S. BANCORP AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF INCOME
(IN MILLIONS, EXCEPT SHARE DATA)

	YEAR ENDED DECEMBER 31,		
	1996	**1995**	**1994**
INTEREST INCOME			
Loans and lease financing, including fees	2207.9	2103.7	1758.8
Securities available for sale	190.1	141.9	137.7
Securities held to maturity	43.5	108.0	125.5

Loans held for sale	13.3	13.2	27.6
Trading account securities	7.8	10.5	9.0
Other interest income	20.7	15.2	15.8
Total interest income	**2483.3**	**2392.5**	**2074.4**
INTEREST EXPENSE			
Deposits	768.2	710.0	523.8
Short-term borrowings	147.4	199.7	135.6
Long-term debt	101.1	83.4	79.3
Total interest expense	**1016.7**	**993.1**	**738.7**
NET INTEREST INCOME	1466.6	1399.4	1335.7
Provision for credit losses	135.2	124.1	120.1
Net interest income after provision for credit losses	**1331.4**	**1275.3**	**1215.6**
NONTINTEREST REVENUES			
Service charges on deposit accounts	197.4	189.5	191.6
Trust and investment management	71.6	65.8	65.3
Bank card revenue, net	59.7	73.4	73.3
Exchange fees	40.4	42.6	36.7
Other operating revenue	156.9	138.3	137.5
Equity investment income (loss)	27.8	3.2	-5.4
Gain on sale of operations and loans	25.6	8.9	62.9
Gain (loss) on sale of securities	5.8	3.0	-9.2
Total noninterest revenues	**585.2**	**524.7**	**552.7**
NONINTEREST EXPENSES			
Employee compensation and benefits	615.2	602.1	646.2
Equipment rentals, depreciation and maintenance	118.8	127.4	139.9
Net occupancy expense	81.7	85.4	87.5
Stationery, supplies and postage	63.2	63.9	59.2
Regulatory agency fees	9.3	35.5	54.1
Amortization of goodwill and core deposit intangibles	22.8	16.6	16.0
Other operating expenses	235.3	261.0	302.2
Merger and integration costs	18.2	98.9	0.0
SAIF assessment	10.3	0.0	0.0
Restructuring charge	0.0	0.0	100.0
Total noninterest expenses	**1174.8**	**1290.8**	**1405.1**
Income before income taxes	741.8	509.2	363.2
Provision for income taxes	262.9	180.2	108.5
NET INCOME	**478.9**	**329.0**	**254.7**
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	466.7	316.8	242.5

NET INCOME PER COMMON SHARE	3.08	2.09	1.60
AVERAGE NUMBER OF COMMON SHARES OUTSTANDING (000's)	**151313.0**	**151554.0**	**151392.0**

EXHIBIT 2c: U.S. BANCORP AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

	(NET UNREALIZED GAIN (LOSS) ON)						
(DOLLARS IN MILLIONS)	**SHARES OUTSTANDING**	**COMMON STOCK**	**CAPITAL SURPLUS**	**RETAINED EARNINGS**	**SECURITIES NET OF TAX**	**PREFERRED STOCK**	**TOTAL**
BALANCE AT JANUARY 1, 1994	**150483832.0**	**752.4**	**469.7**	**1042.4**	**27.2**	**150.0**	**2441.7**
Net income				254.7			254.7
Exercise of stock options	904235.0	4.5	8.4				12.9
Repurchase of common stock	-2228300.0	-11.1	-46.0				-57.1
Common stock issued in acquisition	2410340.0	12.1	4.1	12.6	-1.0		27.8
Common stock issued to redeem subordinated debt	8689.0		0.1				0.1
Common dividends declared (per share -- $.94)				-120.5			-120.5
Preferred dividends declared				-12.2			-12.2
Dividends reinvested and other	545757.0	2.7	9.0	-1.2			10.5
Change in fair value of securities, net of tax					-64.9		-64.9
BALANCE AT DECEMBER 31, 1994	**152124553.0**	**760.6**	**445.3**	**1175.8**	**-38.7**	**150.0**	**2493.0**
Net income				329.0			329.0
Exercise of stock options	723184.0	3.6	9.5				13.1
Repurchase of common stock	-6548525.0	-32.7	-143.1				-175.8
Common stock issued to redeem subordinated debt	3921225.0	19.6	30.1				49.7
Common dividends declared (per share -- $1.06)				-135.7			-135.7
Preferred dividends declared				-12.2			-12.2
Dividends reinvested and other	372031.0	1.8	6.0				7.8
Change in fair value of securities, net of tax					48.1		48.1
BALANCE AT DECEMBER 31, 1995	**150592468.0**	**752.9**	**347.8**	**1356.9**	**9.4**	**150.0**	**2617.0**
Net income				478.9			478.9
Exercise of stock	1396132.0	7.0	26.6				33.6
Repurchase of common stock	-14603800.0	-73.0	-477.6				-550.6

Common stock issued in acquisition	9656911.0	48.3	276.3				324.6
Common dividends declared (per share -- $1.18)				-179.2			-179.2
Preferred dividends declared				-12.2			-12.2
Dividends reinvested and other	157957.0	0.8	5.0	0.1			5.9
Change in fair value of securities, net of tax					-7.2		-7.2
BALANCE AT DECEMBER 31, 1996	**147199668.0**	**736.0**	**178.1**	**1644.5**	**2.2**	**150.0**	**2710.8**

EXHIBIT 2d. U.S. BANCORP AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

	YEAR ENDED DECEMBER 31,		
(IN MILLIONS)	**1996**	**1995**	**1994**
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	478.9	329.0	254.7
Adjustments to reconcile net income to cash used in operating activities			
Deferred income tax (benefit) expense	41.0	-49.8	-47.7
Depreciation, amortization and accretion	153.8	129.0	146.0
Provision for credit losses	135.2	124.1	120.1
Noncash portion of merger and integration costs	14.3	87.6	
Noncash portion of restructuring charge			68.8
Net gain on sales of operations	-28.8		-51.7
Net (gain) loss on sale of equity investments	-23.7	-2.4	5.9
Net (gain) loss on sale of securities	-5.8	-3.0	9.2
Net gain on sale of trading securities	-16.0	-16.2	-4.3
Net gain on sales of loans and property	-17.2	-40.4	-25.8
Net gain on sales of mortgage loan servicing rights	-4.0		-1.0
Change in			
Loans held for sale	-15.2	229.8	552.7
Trading account securities	213.0	-124.3	77.5
Deferred loan fees, net of amortization	0.3	5.4	7.1
Accrued interest receivable	19.6	-15.6	-22.9
Accrued interest payable	-21.8	27.1	7.5
Other assets and liabilities, net	-27.6	86.4	-66.6
Net cash provided by operating activities	**896.0**	**766.7**	**1029.5**
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from maturities of interest-bearing deposits of nonbank subsidiaries	22.3	12.4	21.7
Purchase of interest-bearing deposits by nonbanksubsidiaries	-29.2	-13.0	-12.1
Net decrease in investments in interest-earning deposits by banking subsidiaries	2.8	1.5	5.8

Proceeds from maturities of securities held to maturity	114.2	367.2	777.0
Proceeds from sales of securities held to maturity		3.9	
Purchase of securities held to maturity		-53.2	-426.1
Proceeds from sale of securities available for sale	468.1	993.9	610.1
Proceeds from maturities of securities available for sale	1061.3	610.8	435.0
Purchase of securities available for sale	-1018.3	-1555.2	-913.3
Proceeds from sales of equity investments	40.2	10.0	4.2
Purchase of equity investments	-18.3	-39.8	-18.3
Principal collected on loans made by nonbank subsidiaries	1713.0	1191.5	849.8
Loans made to customers by nonbank subsidiaries	-1919.7	-1398.9	-846.4
Net change in loans by banking subsidiaries	-1674.0	-1681.6	-2103.1
Proceeds from sales of loans	70.5	409.6	122.5
Purchase of loans			-76.5
Proceeds from sales of premises and equipment	24.4	36.2	15.1
Purchase of premises and equipment	-87.8	-81.9	-120.5
Proceeds from sales of mortgage servicing rights	0.7	3.2	24.9
Purchase of mortgage servicing rights		-6.6	-10.6
Proceeds from sales of foreclosed assets	79.2	63.4	47.2
Acquisitions/dispositions, net of cash and cash equivalents	-103.1	15.7	336.5
Net cash used in investing activities	**-1253.7**	**-1110.9**	**-1277.1**
(CONTINUED) CASH FLOWS FROM FINANCING ACTIVITIES			
Net change in deposits	982.1	1401.2	32.8
Net change in short-term borrowings	-1104.4	-824.7	968.7
Proceeds from issuance of long-term debt	1039.2	772.0	631.9
Repayment of long-term debt	-605.2	-439.5	-555.1
Proceeds from issuance of capital qualifying securities issued by subsidiary trust	300.0		
Proceeds from issuance of common stock	26.9	16.4	20.5
Common stock repurchased	-550.6	-175.8	-57.1
Dividents paid	-180.9	-145.3	-128.2
Net cash provided by financing activities	**-92.9**	**604.3**	**913.5**
NET CHANGE IN CASH AND CASH EQUIVALENTS	-450.6	260.1	665.9
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	2922.6	2662.5	1996.6
CASH AND CASH EQUIVALENTS AT END OF YEAR	2472.0	2922.6	2662.5
SUPPLEMENTAL DISCLOSURES			
Cash paid during the period for			
Interest	1038.4	966.3	732.6
Income taxes	192.5	190.5	151.2
Noncash investing activities			
Transfers			
Loans to other real estate owned	73.8	78.2	38.7
Loans to loans held for sale		300.7	
Loans held for sale to loans	12.4	30.2	32.8

Consumer loans from loans held for sale			96.4
Securities held to maturity to available for sale		800.1	
Securities available for sale to held to maturity			56.3
Fair value adjustment to securities available for sale	11.4	81.0	108.3
Income tax effect related to fair value adjustment	4.2	32.9	42.4
Redemption of convertible subordinated debentures		49.9	

EXHIBIT 3a: CONSOLIDATED BALANCE SHEET, COMBINED FIRM

At December 31 (In thousands)	**1997**	**1996**
ASSETS		
Cash and due from banks	$38,056	$43,183
Interest bearing deposits with banks	$163	$1,218
Investment securities:		
Available for sale	$580,115	$455,890
Held to maturity (market value $541,093 on December 31, 1997, and $549,427 on December 31, 1996)	$532,341	$546,318
Assets held in trust for collateralized mortgage obligation	$4,267	$5,259
Loans held for sale	$13,163	$14,809
Loans	$981,739	$929,736
Less: Unearned income	$5,327	$4,819
Allowance for loan losses	$12,113	$13,329
Net loans	$964,299	$911,588
Premises and equipment	$17,630	$18,201
Accrued income receivable	$17,317	$17,362
Mortgage servicing rights	$14,960	$12,494
Goodwill and core deposit intangibles	$19,122	$21,478
Bank owned life insurance	$33,979	$32,451
Other assets	$3,698	$6,861
TOTAL ASSETS	$2,239,110	$2,087,112
LIABILITIES		
Non-interest bearing deposits	$146,685	$144,314
Interest bearing deposits	$992,842	$994,424
Total deposits	$1,139,527	$1,138,738
Federal funds purchased and securities sold under agreements to repurchase	$92,829	$76,672
Other short-term borrowings	$57,892	$79,068
Advances from Federal Home Loan Bank	$754,195	$605,499
Collateralized mortgage obligation	$3,779	$4,691
Long-term debt	$4,361	$4,172
Total borrowed funds	$913,056	$770,102
Other liabilities	$28,347	$26,355
TOTAL LIABILITIES	$2,080,930	$1,935,195
STOCKHOLDERS EQUITY		
Preferred stock, no par value; 2,000,00 shares authorized; there were no shares issued and outstanding on		

December 31, 1997, and 1996	$0	$0
Common stock, par value $2.50 per share; 12,000,000 shares authorized; 5,760,676 shares issued and 4,893,718 outstanding on December 31, 1997; 5,742,264 shares issued and 5,081,004 shares outstanding on December 31, 1996	$14,402	$14,356
Treasury stock at cost, 866,958 shares on December 31, 1997, and 661,260 shares on December 31, 1996	-$31,175	-$19,538
Surplus	$93,934	$93,527
Retained earnings	$78,866	$63,358
Net unrealized gains on available for sale securities	$2,153	$214
TOTAL STOCKHOLDERS' EQUITY	$158,180	$151,917
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$2,239,110	$2,087,112

EXHIBIT 3b: CONSOLIDATED STATEMENT INCOME, COMBINEDFIRM

Year ended December 31 (In thousands, except per share data)	1997	1996	1995
INTEREST INCOME			
Interest and fees on loans:			
Taxable	$81,105	$72,873	$69
Tax exempt	$2,400	$1,560	$2
Deposits with banks	$190	$132	$0
Federal funds sold and securities purchased under agreements to resell	$2	$36	$0
Investment securities:			
Available for sale	$31,769	$29,025	$22
Held to maturity	$38,967	$33,237	$34
Assets held in trust for collateralized mortgage obligation	$355	$470	$0
Total Interest Income	$154,788	$137,333	$129
INTEREST EXPENSE			
Deposits	$42,572	$42,060	$45
Federal funds purchased and securities sold under agreements to repurchase	$5,060	$3,888	$4
Other short-term borrowings	$3,123	$3,706	$2
Advances from Federal Home Loan Bank	$36,648	$25,952	$20
Collateralized mortgage obligatin	$415	$470	$0
Long-term debt	$111	$119	$0
Total Interest Expense	$87,929	$76,195	$73
NET INTEREST INCOME	$66,859	$61,138	$56
Provision for loan losses	$158	$90	$0
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	$66,701	$61,048	$55
NON-INTEREST INCOME			
Trust fees	$4,022	$3,708	$3
Net gains (losses) on loans held for sale	$2,008	$1,060	$0
Net realized gains on investment securities	$792	$638	$0

Gain on disposition of business line	$0	$0	$0
Wholesale cash processing fees	$976	$1,085	$1
Service charges on deposit accounts	$3,323	$3,264	$2
Net mortgage servicing fees	$2,104	$2,312	$2
Bank owned life insurance	$1,644	$1,574	$0
Other income	$5,334	$5,048	$4
Total Non-Interest Income	$20,203	$18,689	$16
NON-INTEREST EXPENSE			
Salaries and employee benefits	$28,197	$25,483	$25
Net occupany expense	$4,431	$4,463	$4
Equipment expense	$3,260	$3,111	$3
Professional fees	$2,928	$2,770	$2
Supplies, postage, and freight	$2,766	$2,693	$2
Misscellaneous taxes and insurance	$1,483	$1,418	$1
FDIC deposit insurance expense	$119	$2,561	$1
Amortization of goodwill and core deposit intangibles	$2,356	$2,360	$2
Other expense	$8,564	$7,615	$6
Total Non-Interest Expense	$54,104	$52,474	$50
INCOME BEFORE INCOME TAXES	$32,800	$27,263	$21
Provision for income taxes	$9,303	$7,244	$6
NET INCOME	$23,497	$20,019	$15
PER COMMON SHARE DATA:			
Basic:	$4.69	$3.85	$0.00
Net income	$5,014,376.00	$5,195,364.00	$5,468.00
Average number of shares outstanding			
Diluted:			
Net income	$4.61	$3.83	$0.00
Average number of shares outstanding	$5,091,424.00	$5,231,587.00	$5,480.00
Cash Dividends Declared	$1.60	$1.37	$0.00

EXHIBIT 3c: CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
(In thousands)

	Preferred Stock	Common Stock	Treasury Stock	Surplus	Retained Earnings
Balance at December 31, 1994	$0	$14,275	-$3,064	$92,923	$40,355
Net income for the year 1995	$0	$0	$0	$0	$15,803
Stock options exercised	$0	$59	$0	$438	$0
Net unrealized holding gains on available for sale securities	$0	$0	$0	$0	$0
Cash dividends declared:					
Common stock ($0.25 per share on 5,584,722 shares; $0.27 per share on 5,531,966 shares; $0.27 per share on 5,034,457 shares; and $0.27 per share on 5,310,489 shares)	$0	$0	$0	$0	-$5,757
Treasury stock, 295,512 shares at cost	$0	$0	-$7,943	$0	$0
Balance at December 31, 1995	$0	$14,334	-$11,007	$93,361	$50,401

Net income for the year 1996	$0	$0	$0	$0	$20,019
Stock options exercised	$0	$22	$0	$166	$0
Net unrealized holding losses on available for sale securitites	$0	$0	$0	$0	$0
Cash dividends declared:					
Common stock ($0.27 per share on 5,266,539 shares; $0.30 per share on 5,147,403 shares; $0.30 per share on 5,081,004 shares; and $0.20 per share on 5,081,004 shares)	$0	$0	$0	$0	-$7,062
Treasury stock, 238,048 shares at cost	$0	$0	-$8,531	$0	$0
Balance at December 31, 1996	$0	$14,356	-$19,538	$93,527	$63,358
Net income for the year 1997	$0	$0	$0	$0	$23,497
Stock options exercised	$0	$46	$0	$407	$0
Net unrealized holding gains on available for sale securities	$0	$0	$0	$0	$0
Cash dividends declared:					
Common stock ($0.30 per share on 5,085,429 shares; $0.35 per share on 5,021,429 shares; $0.35 per share on 4,993,318 shares; and $0.25 per share on 4,893,718 shares)	$0	$0	$0	$0	-$7,989
Treasury stock, 205,698 shares at cost	$0	$0	-$11,637	$0	$0
Balance at December 31, 1997	$0	$14,402	-$31,175	$93,934	$78,866

EXHIBIT 3d: CONSOLIDATED STATEMENT OF CASH FLOWS:COMBINED

Year ended December 31 (In thousands)	**1997**	**1996**	**1995**
OPERATING ACTIVITIES			
Net income	$23,497	$20,019	$1
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	$158	$90	$0
Depreciation and amortization expense	$2,430	$2,564	$0
Amortization expense of goodwill and core deposit intangibles	$2,356	$2,360	$0
Amortization expense of mortgage servicing rights	$1,806	$1,249	$0
Net amortization (accretion) of investment securities	$218	$182	$0
Net realized gains on investment securities	-$792	-$638	$0
Net realized (gains) losses on loans held for sale	-$2,008	-$1,060	$0
Origination of mortgage loans held for sale	-$260,984	-$191,299	-$10
Sales of mortgage loans held for sale	$258,261	$196,238	$9
Decrease (increase) in accrued income receivable	$45	-$610	$0
Net gain on disposition of business line	$0	$0	$0
Increase in accrued expense payable	$1,385	$397	$0
Net cash provided by operating activities	$26,372	$29,492	$1
INVESTING ACTIVITIES			
Purchase of investment securities and other short-term investments	-$686,087	-$633,641	-$46
Proceeds from maturities of investment securities and other short-term investments	$164,721	$128,973	$10
Proceeds from sales of investment securities and other short-term investments	$414,682	$389,068	$27
Long-term loans originated	-$322,491	-$333,343	-$26
Loans held for sale	-$13,163	-$14,809	$0

Principal collected on long-term loans	$288,669	$240,679	$24
Loans purchased or participated	-$2	-$1,614	-$3
Loans sold or participated	$234	$663	$9
Net decrease (increase) in credit card receivables and other short-term loans	$261	-$2,222	$0
Purchases of premises and equipment	-$1,913	-$2,227	$0
Sale/retirement of premises and equipment	$54	$49	$0
Net decrease in assets held in trust for collateralized mortgage obligation	$992	$1,840	$0
Increase in mortgage servicing rights	-$4,272	-$2,371	$0
Cash received from disposition of business line	$0	$0	$0
Premium paid to purchase bank owned life insurance	$0	$0	-$3
Net decrease (increase) in other assets	$583	-$817	$0
Net cash used by investing activities	-$157,732	-$229,772	-$7
FINANCING ACTIVITIES			
Proceeds from sales of certificates of deposit	$270,064	$248,589	$3
Payments for maturing certificates of deposit	-$258,653	-$272,838	-$3
Net decrease in demand and savings deposits	-$10,622	-$14,871	$0
Net (decrease) increase in federal funds purchased, securities sold under agreements to repurchase, and other short-term borrowings	-$5,931	$59,527	-$1
Net principal borrowings on advances from Federal Home Loan Bank	$148,696	$177,282	$2
Principal borrowings of long-term debt	$5,068	$0	$0
Repayments of long-term debt	-$4,879	-$889	$0
Common stock dividends paid	-$9,305	-$4,522	$0
Proceeds from dividend reinvestment and stock purchase plan and stock			$0
options exercised	$453	$188	$0
Purchases of treasury stock	-$11,637	-$8,531	$0
Net increase (decrease) in other liabilities	$1,924	$578	$0
Net cash provided by financing activities	$125,178	$184,513	$0
NET (DECREASE) INCREASE IN CASH EQUIVALENTS	-$6,182	-$15,767	$0
CASH EQUIVALENTS AT JANUARY 1	$44,401	$60,168	$0
CASH EQUIVALENTS AT DECEMBER 31	$38,219	$44,401	$0

EXHIBIT 4. RATIO COMPARISON WITH INDUSTRY:
US Bancorp, December 1997
source: Hoover's Company Information 1998, Hoover's, Inc. Austin, TX

PROFITABILITY RATIOS	**COMPANY**	**INDUSTRY**	**MARKET**
Gross Profit Margin			45.49
Pre-Tax Profit Margin	20.07	20.62	7.9
Net Profit Margin	12.05	13.9	5.72
Return on Equity	12.2	14.8	15.1
Return on Assets	1.1	1.3	2.9
Return on Invested Capital	4.5	7.2	7.9

VALUATION RATIOS	**COMPANY**	**INDUSTRY**	**MARKET**
Price/Sales Ratio	5.61	3.81	1.37
Price/Earnings Ratio	40.01	28.36	28.79
Price/Book Ratio	5.69	4.05	3.62

Price/Cash Flow Ratio	46.35	27.59	12.49

OPERATING RATIOS	**COMPANY**	**INDUSTRY**	**MARKET**
Days of Sales Outstanding			48.87
Inventory Turnover			7.8
Days Cost of Goods Sold in Inventory			46
Assest Turnover	0.1	0.1	0.6
Net Receivables Turnover Flow			8.2
Effective Tax Rate	39.9	35.9	41.1

FINANCIAL RATIOS	**COMPANY**	**INDUSTRY**	**MARKET**
Current Ratio			1.43
Quick Ratio			0.8
Leverage Ratio	11.59	11.75	5.13
Total Debt/Equity	1.85	1.65	1.28
Total Debt/Equity	1.85	1.65	1.28
Interest Coverage	1.6	1.6	2.4

PER SHARE DATA ($)	**COMPANY**	**INDUSTRY**	**MARKET**
Revenue Per Share	8.35	13.31	28.21
Fully Diluted Earnings Per Share from Total Operations	1.17	1.79	1.34
Dividends Per Share	0.66	0.78	0.48
Cash Flow Per Share	1.01	1.84	3.09
Working Capital Per Share			0.19
Long-Term Debt Per Share	14	13.05	9.46
Book Value Per Share	8.23	12.54	10.67
Total Assets Per Share	95.41	147.23	54.77

GROWTH RATES	**COMPANY**	**INDUSTRY**	**MARKET**
12-Month Revenue Growth	68.5	31.7	12.3
12-Month Net Income Growth	1.8	18.3	14.3
12-Month EPS Growth	26.4	4.7	3.1
12-Month Dividend Growth	13.8	16.4	7.7
36-Month Revenue Growth	32.2	14.1	9.4
36-Month Net Income Growth	19	13.4	13.8
36-Month EPS Growth	6.2	2.2	1.1
36-Month Dividend Growth	13.1	2	5.1

Exhibit 5. MARKET CAPITALIZATION RANKINGS (BANKS)
TOP 30 COMPETITORS

source: Quicken.com Quote Plus

Symbol	Company Name	Market Cap ($000)
NB	NATIONSBANK CORP	$83,395,515
CCI	CITICORP	$78,678,057
BAC	BANKAMERICA CORP	$67,545,027
CMB	CHASE MANHATTAN CORP	$63,474,898
FTU	FIRST UNION CORP	$61,110,842
ONE	BANC ONE CORP	$41,998,320
USB	U S BANCORP DEL	$34,777,053
WFC	WELLS FARGO &CO	$32,439,095

BNOB	NORWEST CORP	$28,852,161
FCN	FIRST CHICAGO NBD CORP	$27,318,759
FLT	FLEET FINL GROUP INC NEW	$24,243,083
NCC	NATIONAL CITY CORP	$23,569,150
CFL	CORESTATES FINL CORP	$19,425,168
MEL	MELLON BANK CAP NTS	$18,962,804
KRB	MBNA CORP	$18,356,011
STI	SUNTRUST BKS INC	$17,680,211
WB	WACHOVIA CORP NEW	$17,649,967
PNC	PNC BK CORP	$17,597,385
BKB	BANKBOSTON CORP	$16,666,908
KEY	KEYCORP NEW	$15,897,565
CRZBY	COMMERZBANK A G	$15,273,469
CMA	COMERICA INC	$11,011,781
BBK	BB&T CORP	$9,951,958
SUB	SUMMIT BANCORP	$8,510,249
PVN	PROVIDIAN FINANCIAL CORP	$7,796,560
UPC	UNION PLANTERS CORP	$7,692,588
RNB	REPUBLIC N Y CORP	$7,581,092
FOA	FIRST AMER BK CORP	$7,539,859
MTL	MERCANTILE BANCORPORATION	$7,384,325
FSR	FIRSTAR CORP NEW	$7,102,789

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BASA: A CASE OF SMALL BUSINESS FRAUD

JoAnn C. Carland, Western Carolina University
James W. Carland, Western Carolina University

CASE DESCRIPTION

The primary subject matter of this case concerns fraud in a small business. The case has a difficulty level of three. Secondary issues involve business valuation and succession. This case may be taught in small business or accounting classes. The case is designed to be taught in a three hour class or two or three one-hour classes and is expected to require up to two hours of outside preparation by the student.

CASE SYNOPSIS

BASA is a small service company which repairs buses. The owner has behaved in an expense preference manner for the entire tenure of his business. He was diagnosed with cancer about three years earlier and had entered into negotiations with a buyer to purchase the business prior to his death. Yet when his doctor later suggested that the cancer was in remission, the owner decided to keep the business and continue running it. Because he was small, he had performed his own bookkeeping or had a friend come in on occasion and help him out. After his brush with death, however, he hired a defrocked CPA to take care of the day to day accounting activities. Several months ago, the owner felt ill, entered the hospital for some tests, and died within the week. He had not finalized his plans concerning what to do with the business upon his death, and the widow was forced to take over the business quickly as it began to have severe cash flow problems.

We were asked to come in and value the business for sale and when we asked for the financials for restatement purposes, the accountant admitted his guilt. He had taken over $10,000 from the company. The case deals with the particulars of that event.

TOWARDS A CRITICAL PEDAGOGY FOR MANAGEMENT EDUCATION: A POSTMODERN ANALYSIS OF THE INTERNATIONAL MONETARY FUND AS A LIVE CASE

Loren Dyck, Hawaii Pacific University
Art Whatley, Hawaii Pacific University

ABSTRACT

The process of globalization requires a rethinking of the key competencies and abilities held by graduates from our MBA programs. Prior knowledge is made increasingly obsolete in this new era where global economic forces supersede the power of all but the most powerful the nation states. Business education must break with its long standing reliance on teaching that is conventional, driven by a learning model based on knowledge acquisition through the medium of standard textbooks and "fact the front" classroom designs. This type of learning maintains existing organizational arrangements and established ways of managing more appropriate for stable environments. It fosters reliance on past experiences and traditional modes of action that are inappropriate for the novel problems and circumstances created by globalization and the information revolution.

THE CUSTOMER COMES SECOND: EMPLOYEE SATISFACTION LEADS TO CUSTOMER SATISFACTION

Patricia L. Hoch, Southeast Missouri State University
Charles R. Wiles, Southeast Missouri State University
Jack Sterrett, Southeast Missouri State University

CASE DESCRIPTION

This case uses the implementation of the process of employee physical examinations/ wellness at a rural hospital to address the following concepts of Total Quality Management: continuous improvement; internal customer satisfaction; external customer satisfaction; employee empowerment; and, use of cross-functional teams.

It is designed to be taught in a 60 to 70 minute, upper level, undergraduate or graduate class in Quality Management that could involve group discussions of options that arise. Outside classroom preparation is expected to require up to two hours. The case could also be used in course work in the areas of Human Resource Management or Healthcare Management.

CASE SYNOPSIS

A small, rural health care provider, faced with shrinking resources, turned to Total Quality Management and its tools to find ways to function more efficiently and effectively. This case presents a unique example of how empowered employees, through team efforts, were able to improve the process of annual employee physicals in their organization. This ultimately helped them to realize how self-improvement, specifically through improved health and well being, has a dramatic and favorable effect on the provision of services to external customers. Questions arose concerning whether the cost effectiveness of such improvements were really in the best interest of the ultimate consumer--the community it serves.

INTRODUCTION

The ever-changing environment of health care, including attempts to keep pace with technology, coupled with a reduction in operating income and the outcry of the public, the government, and the media for answers as to why health care costs continue to increase, have forced many health care organizations to take a hard look at themselves. Webster Memorial Hospital, a small community based not-for-profit hospital located in rural Missouri, was faced with these same challenges. Like many other health care providers, it turned to the philosophy of Total Quality Management (TQM) and a dedication to continuous quality improvement (CQI) as a means of remaining viable. As part of this process, particular attention was paid to opportunities to improve systems and processes within the hospital structure. Employees were educated in the principles of

TQM, were called upon to become an integral part of the process, and were assured the support of administration and upper management. Realizing TQM can provide powerful processes for solving operational problems, many tools were put into use by the hospital in the hope of an improved work environment and ultimately the increased satisfaction of the external customer - the community.

Webster Memorial knew communication was one of the keys to the success of any total quality system and found teams to be a great forum for such communication. The use of QAT (Quality Action Team) then became the vehicle through which processes and procedures were analyzed and improved. The involvement of employees from various departments and disciplines on each of these teams became an essential part of the process. One of the processes found to be in need of redesign was the procedure in place to facilitate annual employee physicals. The current process was outdated, cumbersome, and did not take advantage of the newer technology and professional resources that were now available. Many employees were also frustrated with the process that often took too long and were not feeling any noticeable benefits. The use of QAT to focus on this process provided a unique opportunity for newly empowered employees to benefit the "internal" customer and ultimately have a positive effect on the external customer as well.

One of the first steps in identifying areas of improvement in the annual physical process included flowcharting the current procedure. What was found was an extended process that involved a notification of the employee by the Outpatient department of the upcoming annual physical along with instructions to contact outpatient to schedule a day for the required diagnostic testing. On the scheduled day, a stop must first be made at the admitting office to be assigned an account number, followed by a trip to the laboratory, radiology and outpatient departments. One of the mandated tests, a PPD, required a return trip to the outpatient department 72 hours later to be checked. Physical exams were usually conducted by the physician on duty and may have been completed at the time of the employee's first visit, scheduled for a later date, or postponed indefinitely, dependent upon the patient load in the outpatient department. The results of the diagnostic testing, when completed on the same day, were usually not available for review during the actual physical examination.

As the QAT team focused on possible ways to improve this process, two different options became apparent. Only the PPD diagnostic test, which is a TB skin test, is required of all employees by outside agencies. Eliminating all other diagnostic procedures and the annual physical exam itself would lighten the workload significantly in the outpatient and ancillary departments and would reduce costs. This was the first option. The second option, suggested by employees, was streamlining the entire process, establishing a timetable for when all the elements of the process were to be completed, and setting aside specific times solely for annual employee physical examinations. A nurse practitioner, a member of the QAT team who would become the individual responsible for dedicating the time to conduct the physical exam portion of the process, took the suggested changes one step further. The consideration whether to establish an employee wellness program incorporating the revised annual employee physical process with the education and resources necessary to improve overall employee health was discussed. She cited numerous studies reporting increased productivity, reduced absenteeism, and a positive impact for the organization by reducing health care costs, sick leave, disability claims, and workers' compensation. Also suggested was a required consultation with the nurse practitioner as the final step in the process at which time the results of any diagnostic testing could be fully explained, questions answered, and the opportunity used to promote an increased awareness of a healthy lifestyle. Computer programs could even be purchased for a nominal cost that

incorporate diagnostic results with individual medical histories and lifestyles for a more personalized picture of employee health.

Representatives from the outpatient department were part of the QAT team and recognized the need to make changes but feared the additional workload involved in the suggested increase in scope from a simple annual employee physical to a comprehensive wellness program.

METAMORPHOSIS: THE CHANGES OVER TIME

David L. Stamm, Florida Institute of Technology

CASE DESCRIPTION

The primary subject matter of this case concerns management of change. The case has a difficulty level of four. Secondary issues examined include use of Change Agents. Internal/external Consultants, Company values, Leadership and Goals and Objectives. The case is designed to be taught in a one-class hour and is expected to require up to two hours of outside preparation by the student.

CASE SYNOPSIS

Fiscal year 1994 became the most challenging year in the corporate life of Nichols Research. After 17 years of growth a significant decline in Department of Defense (DoD) funding, a major customer, together with an increasingly competitive business environment, had contributed to a decline in revenues. Management needed to determine how best to respond to the decrease in the company's overall financial performance.

AN ATTEMPT TO IMPROVE EFFICIENCY AND CUSTOMER SATISFACTION BY IMPLEMENTING AN EMPLOYEE PROFIT SHARING PROGRAM

Chris Walker, Southeast Missouri State University
Charles R. Wiles, Southeast Missouri State University
Jack Sterrett, Southeast Missouri State University

CASE DESCRIPTION

The primary subject matter of the case concerns the implementation of an employee profit sharing program. The case also demonstrates the importance of quality concepts in the implementation of any new program or process. The student will be made aware that employee involvement is critical in designing a program that affects them and that there is a relationship between internal customer satisfaction and external customer satisfaction. The importance of education and training when implementing a new program is demonstrated. Also the concepts of cross functional teams, empowerment, and continuous improvement can be discussed. Finally, the case can be used to demonstrate how Deming's 14 points relate to the implementation of a new program involving employees. The teaching note was written for instruction in upper level undergraduate courses in Total Quality Management or MBA level courses in Managing Quality. It may also be useful in course in Human Resource Management.

CASE SYNOPSIS

A company has designed and implemented a profit sharing program at one of their most efficient plants. The profit sharing program is based on meeting or exceeding safety, quality and production goals. All employees, including supervisors, share in the bonus pool created for attaining these goals. Only the plant manager is not included in the profit sharing program. The key areas were all related separate of one another and thus could have an impact on the final amount that was put into the bonus pool. Thus, it was important to attain high values in all areas. This was done to ensure needed balance across the entire plant so that one area would not be suboptimized at the expense of another (e.g., attaining record production levels at the expense of reduced quality and a less safe environment). The employees were given the opportunity/authority to make changes in the processes. The more the processes improved, the higher the performance would be and the bonus pool would grow. Thus, it was necessary for all personnel to work togther for successful accomplishment of the program.

The implementation of this profit sharing program at one of their more efficient plants encountered many problems. Accidents increased, while plant efficiencies and quality levels decreased. In fact, the employees contacted a local union organization and began the preliminary steps to form a union at the plant. The company does not want union representation in the plant. Should the profit sharing program be withdrawn?

INTRODUCTION

Minerals Inc. had purchased a company with $400 million in annual sales as part of their strategic plans for the future. This acquisition would allow them to dominate their part of the industry and serve their customers in a very efficient manner. The company they purchased had the number one brands in their respective categories.

However, due to the price Minerals Inc. paid for the new acquisition they were now faced with a heavy debt load due to the fact that the purchase had been a leveraged buy out. The purchase included five production facilities in the United States and one production facility in Canada. Minerals Inc. knew they would be faced with a heavy debt load and had planned on incorporating employee profit sharing programs at all of the production facilities in order to help reduce debt. They felt the profit sharing program would improve efficiency customer satisfaction, and profit levels.

Minerals Inc. had inherited one production facility from the acquisition on the East Coast that had union representation. This facility had an incentive program that was based on production levels only. The company knew they did not want to incorporate a similar program at their other facilities.

Thus, a team of corporate managers was formed to develop an efficient profit sharing program. The team was composed of an Engineer, an Accountant, and the Director of Manufacturing. They drafted a profit sharing program that was composed of several key areas. These areas included safety, quality, mining, production, packaging and shipping. Each area had established scales with minimum rating levels that needed to be reached in order to generate additional profit. The higher the performance was in each area the higher the rating on the scale and the more profit there was that went into a bonus pool. If minimum levels were not attained then money could be removed from the bonus pool.

The key areas were all rated separate of one another and thus could have an impact on the final amount that was put into the bonus pool. Thus, it was important to attain high values in all areas. This was done to insure needed balance across the entire plant so that one area would not be suboptimized at the expense of another (e.g., attaining record production levels at the expense of reduced quality and a less safe environment). The employees were given the opportunity/authority to make changes in the processes. The more the processes improved, the higher the performance would be and the bonus pool would grow. Thus, it was necessary for all personnel to work together for successful accomplishment of the program.

All employees, supervisors, and office staff were a part of the profit sharing program. The only person not part of the profit sharing program was the plant manager. The rating for the profit sharing program was calculated at the end of each month. The payout for the program was made each quarter with 20 percent of the bonus pool retained until the end of the year in case of any shortfalls for any months.

After several months of work the profit sharing program was ready to be deployed. Minerals Inc. made the decision to implement the profit sharing program at their West Coast facility. The work history of this plant had been good. It had some of the highest production efficiency ratings of the company. It had not had a lost time accident in over three years. The workforce was quite diverse and consisted of several nationalities. The majority of the people consisted of Indians native to India and Hispanics. Language barriers had been a problem in the past.

The management team that has developed the program went personally to the plant to unveil the program to the employees. The plan was presented in three large shift meetings to all personnel. The program was then put into effect.

Six months after the institution of the program morale was very low, quality levels were low, and production efficiencies were low. Plant management was informed that the employees had contacted a local union for representation of them at the plant.

Minerals Inc. began investigating the cause of the problems. After days of small group meetings they discovered that the profit sharing program was being used as a hammer by the supervisors against the employees. The program had created conflicts that had not existed previously. Everyone was pointing the blame at one another. The employees did not understand how the program/incentive levels worked for their respective areas.

WIN-$UM COACH LINES: A CASE STUDY

Maggie Forbes, Western Carolina University

CASE DESCRIPTION

The primary subject matter of this case concerns ethics and entrepreneurship. The case is designed for senior level, undergraduates and is expected to require two hours of outside preparation and to consume two hours of class discussion time. The case is useful in a small business management course, business ethics course, entrepreneurship course, or business law course.

CASE SYNOPSIS

The case describes a year in the life of a prospective entrepreneur. It tells the story of a business student who attempted to turn a class project into an actual business: Win-$um Coach Line. The business would utilize buses to ferry individuals and groups to and from selected cities to a recently opened, Indian casino. The venture, which seemed promising from every angle, seemed poised on the edge of success, when an unethical act on the part of the Casino destroyed Win-$um Coach Lines before it carried its first passenger.

INTRODUCTION

In 1996, the Eastern Band of Cherokee Indians contracted with Harrah's Entertainment, Inc., to build a 175,000 square foot casino in a nearby town. Construction was underway and the idea to have a daily shuttle service to and from the casino from the Atlanta, Georgia, Knoxville, Tennessee, Asheville, North Carolina, and Charlotte, North Carolina, was born.

In discussions with my Professors, it was decided that a student group would spend the semester developing a feasibility study and business plan. It was understood that I was really going to open Win-$um Coach in the Fall. Immediately the team and I set out to build Win-Sum Coach, Inc. I must commend this collegiate team for putting together an impressively complete package. The business plan drew praise from all who perused it.

THE TURNING POINT

April was a turning point. I met with the Cherokee Tribe to inform them of my intentions and as long as the business was not based on tribal property they had no objections. My next meeting, in May, was with Marsha Cameron, the Director of Marketing of the Cherokee Casino and her boss, Gaye Gullo, from Memphis. This meeting lifted my entrepreneurial spirits to a new height. We discussed special amenities my company would offer, the busses I would lease, and insurance I would need. Other topics of discussion included territories I would serve, and I was happily informed that

Harrah's did not get involved with territories, so the sky was the limit. I was told Harrah's would share in advertising costs and refer my company to inquiries received, as well as offering a five dollar chip credit to each customer I delivered. We spoke of my possibly taking a trip to one of their other casino's in New Jersey to see the bus operations. Bus companies in New Jersey paid a percentage of their fares to local stores who promoted the service and Gaye thought I would benefit from a trip there. We even discussed the possibility of using Win-$um Coach for local shuttle services while our customers visited Harrah's facility. Overall, the meeting was enlightening and I had a lot of work ahead of me. The casino was tentatively scheduled to open in early Fall of 1997.

As time went by, I spoke numerous times to Marsha, keeping her informed of every new detail in the development of the business. She continually exhibited a vast amount of enthusiasm over the business. In July she faxed me a sample contract. This was at my request, and was needed so my lawyer could scrutinize the conditions of the contract. I also needed it to aid in obtaining financing for the busses.

On August 14th, 1997, I placed a call to Marsha. I had placed several calls previously and received no response. This was very unusual. Up to this point she was prompt in returning calls. I called her boss in Memphis only to find out they were both out of town at a meeting, "somewhere in Ohio." Nevertheless, I finally received a call back from her about seven o'clock in the evening. I explained that my urgency in contacting her was because I was about to expend a large sum of money, and worried about doing so without a signed contract. I needed assurance from her that I would have a contract with Harrah's. Her final words to me in that conversation were, " Maggie, do whatever you have to do, you *will have* a contract with Harrah's".

RED FLAGS

In the beginning of September, I called to speak with Marsha and reached her new secretary Regina. During this call I was informed that a letter had gone out to all potential line-run operators asking for information about their companies and the vehicles they were planning to use. The problem was, I never received the letter! I was told it wasn't sent because they did not have my address. WRONG! We had corresponded on several occasions over the past few months and they had my address on file. Regina informed me the information was already past due but she would put it in the mail immediately, and I would need to get it back to her ASAP. I hand delivered the requested information on the ninth of September. This was, or should have been, the first indication that something wasn't right. I saw it as an oversight of Harrah's.

My second red flag should have been when Regina told me in the middle of September (after several calls to check on the status of my contract) that I now needed to contact another person who was working on transportation issues. I placed two long distance calls to a woman named Mary Reilly and never received a call back. Subsequently a third call placed around the end of September was transferred to yet another NEW transportation coordinator's office. As far as I knew, we still were going to sign a contract at the end of October, as I had been assured by Marsha.

By summer's end, Win-$um Coach, Inc. had leased and renovated an office, ordered computers, as well as a specially designed reservation program. I was making final decisions on the busses, one computer system was purchased and three others ordered. Cell-phones were purchased, special telephone lines installed, and furniture and equipment was arriving, as planned. The company

manual was almost complete and I was gathering my work force. I hired an office manager with 20 years experience and two office assistants. Advertising was in print and scheduled. Classified ads were ready to be placed for bus drivers, and promotional orders started arriving, My team was excited and we were truly on the entrepreneurial path. We were just waiting to turn the corner.

The scheduled date for the casino to open was November 13, 1997 Having met our objectives to this point, it was clear to my team that the office would be fully staffed and open for reservations on Monday, October 13th.

On October 7, 1997, I placed a call to Marsha at Harrah's and was told she no longer handled transportation issues. I would have to speak with the transportation coordinator. This person, Laura, informed me that I am not included in the pool of applicants for line-run operators serving Harrah's. WHAT! This is crazy! How could this be? I informed her of my months of preparation and my continued conversations with Marsha, and that advertising has already started. I told her about the contract signing date scheduled for October 26th. This has to be a mistake. She tells me she will check it out and call me back. Meanwhile, I am frantic. This can't be happening! I pick up the telephone and call Marsha myself only to get her voice mail. I leave a frantic message for her to call me.

How the ball bounces in the corporate arena. One hour passes and I receive a call back from Laura. She leaves a message on my voice mail apologizing for the mistake and assures me I will have a contract with Harrah's. Shortly thereafter, Marsha returns my call. She, too, apologizes, and tells me not to worry: the signing date is still on.

We are truly a team, everyone is putting his or her best foot forward and no one is stopping. Local advertising begins, a press release is sent to the papers which is scheduled to run on Sunday October 11th in the business section of the *Asheville Citizen Times.* Flyers are distributed, presence at a local business show is scheduled for the 11th through the 13th, and the team gathers to peel and stick 6,000 magnetic business cards together.

On October 13th, we opened for reservations. It was quiet a good portion of the day but we did have a few calls and we were pleased with that. The two office assistants were in Asheville handing out magnetic business cards and flyers at the business show. Interest in the service was high and we were encouraged.

THE RIDE GETS BUMPY

Hold on to your seats, the ride is about to get bumpy. On October 14th, at 10:00 AM, the phone rings at Win-$um Coach Line's office. It is a *Sales Manager* from Harrah's named Tina. She starts questioning me about the business. First, she asks how much insurance I will carry on the busses. I told her that we would carry the $5 million required under the terms of the contract. She informs me it will now be $10 million. Then, she asks how many busses I own. I tell her none. I am leasing them. Her response was, that I could not be a line-run operator for Harrah's unless I owned five, 48 passenger busses. Now I needed to own the buses, AND, their seating capacity had to be 48 passengers. I had intended to lease 29 passenger busses. Not only that, she tells me that even if I could have a contract with Harrah's, it would NOT be for the areas I had planned to service because they had already signed contracts with other companies for those territories. That's impossible I tell her, because I was told from day one that Harrah's does not get involved in territories. Her response

gave me little satisfaction. She said “I don’t know who told you that but those territories are no longer available.”

I thought I was freaking out! I couldn’t be hearing this! I informed her of my understanding with the Director of Marketing, Marsha. She did not seem to care much, but she told me that she would check it out and get back to me. Less than an hour passed and I received a call back from her asking me to meet with her at two o’clock, that afternoon.

Prior to the meeting I placed some calls. The first call was to Marsha, and another call was to the General Manager of Harrah’s Cherokee Casino, Jerry Eglus. Neither was available, so I left messages. It was my understanding that Marsha was out of town and that the General Manager was in a meeting at the time of my call.

My meeting with Tina left a bad taste in my mouth. She informed me she was waiting for an answer from Harrah’s attorney in Memphis to see if they would waive the requirements of owning the busses for me. I was surly not going to get a contract for the areas I had planned for, and the market they were offering showed no possibility for profit. The conditions of my original contract had changed and I was being told I had to compete for the territories now offered. I left the meeting with the understanding that Tina would contact me the next day with word from Harrah’s legal team. In the meantime, she encouraged me to check out the areas we discussed. I informed her that I would take the weekend to travel to these areas and gather the statistics needed to see if it was a possibility.

On October 15, 1997, I heard nothing from Tina so I placed a call to her late in the day. I left a message on her voice mail with both my office and home phone numbers, so she could contact me at any hour. On October 16, 1997, I had still received no call from Tina. I left two more messages. At about 4:00 PM, she called and told me she was in training and still had not heard from the lawyers in Memphis. She took my home phone number and promised that she would call me that evening. We discussed my trip to the target areas that weekend and ended the conversation. She did not call back.

On October 17, 1997, I called Marsha and spoke with her about what was going on. The conversation was short and to the point. Marsha told me that she would check with Tina and have her call me. When I tried to discuss the particulars of what Marsha had promised me and what was now happening, she avoided it and just stated that Tina was in charge and I would have to deal with her.

Again I left a message for Tina with times and phone numbers to reach me. About three in the afternoon, my daughter answered the phone at home. It was Tina. She told Tina I was at work and waiting for her call. Tina replied by telling my daughter that she would immediately call back on that same number and leave a message for me on my voice mail. She did that, and my daughter called me at the office to inform me of what had just transpired. I checked my voice mail and her message stated that the lawyer was leaning toward having all line run operators abide by the same rules. Consequently, I did not need to waste my time in travel to the target areas over the weekend. She concluded the message by saying that she would contact me on Monday, October 20th.

On October 21st through Oct 26th, I placed several calls to Tina. There was no response and no return calls.

On October 27th, I placed calls to not only Tina but to Jerry Egelus and Marsha, as well as Laura. Laura was the first to return my call and she informed me that Tina was away on a trip. Furthermore, she knew that Tina had sent me two letters. I had received no letters. She said she

would check my file and get back to me. Next, I heard from Marsha and she also told me of the letters. She said she would check with Laura to see what was going on.

In the meantime I called the post office and found out that I did have two letters from Harrah's that had just arrived. I sent my daughter to pick them up. While waiting for the mail, Laura called and I told her of the letters at the post office. She told me that when Tina checked in that day she would schedule a conference call with the three of us so we could clarify the matter.

With letters in hand, I was amazed at the contents. First, there was a statement telling me that I had no right to advertise my business in conjunction with Harrah's, and if I continued, legal action would be taken against me. Then, there was an offer for the target areas that Tina had previously told me not to bother checking. However, there was a stipulation that I must comply with the additional requirements "as outlined in the bus service agreement" in order to obtain those territories.

At 6:30 PM, the conference call came. My first question was what and where are the additional requirements as stated in the letter? Tina informed me that I would need to own (not lease) at least five busses and they could be no more than five years old. They must be 48 passenger with a bathroom (instead of the 29 passenger they knew I had planned). I needed $10 million in insurance instead of $5 million. At the end of the call, I asked them both how I would know what the requirements were if I had never received them. Laura responded with "good question". Tina responded with, "you received a sample contract and it states them in there". I responded with " the only thing it states in the contract is that I have enough seating capacity on the bus so that no one would have to stand for any portion of the trip". Her response was that there were additional requirements I obviously had not received. Based on this, Laura apologized for the mix-up and asked me to come by the casino and pick-up the information the next day. We ended the conversation with my expressing my disbelief over the fact that I was the first to approach them in April and the last to receive the information or a contract.

On October 28th, Jerry Egelus finally returned my call. I expressed my concerns. He stated that he was not receiving the same story from his people and suggested a meeting with all concerned to settle the matter. His secretary would call me back with a time and date.

I picked up the information from Laura and after reading it, I was dumbfounded. Nowhere in the entire contract (for the new target area) was there any of the "additional requirements" discussed the night before. I t doesn't say I need to own my busses, nor does it state that they need to be of a certain seating capacity. I immediately placed a call to Laura and informed her of this. She would check it out and get back to me. To this day I have not heard from her.

The same day I called Tim Reid at the Asheville Citizen Times to find out why my article had not run. He informed me someone named Tina Littrella had called and told him not to run the article because the information was not accurate. What right did she have to call and cancel my press release? On the same day I checked my voice mail to make sure the voice mail message from Laura on October 7th assuring me of a contract was still saved. I checked it every day so I would not lose it. Much to my surprise, it was gone. After a conversation with GTE who was handling my voice mail, I feel confident that someone from Harrah's called and had it removed.

On October 30th, Marsha called to set up the meeting discussed with Jerry Egelus. It was agreed that we would meet on November 6th, at 1:00 PM at the new casino. I promptly called my legal counsel and he agreed to attend the meeting with me.

On November 6th, 1997, we arrived at the casino about 12:45 PM, and went to security as directed. After obtaining clearance we proceeded to the corporate offices. There, we met Tina and Marsha. They directed us to a conference room and my lawyer introduced himself and gave them his business card. After about five minutes, Marsha excused herself so she could go and hurry up Jerry Egelus. Laura would not be attending the meeting.

During their absence, Tina told us of another company that had just bought six, new, 48 passenger busses to handle runs in what they had thought was their territory. Tina said that Harrah's wasn't going to use that company because it was new and had no track record. She seemed unconcerned that those would be entrepreneurs had just spent nearly $1.5 million! You can guess how the rest of the meeting went!

WHAT NOW?

I intend to sue the company, but the burning questions that keeps going through my mind are, "What could I have done differently? Where did I go wrong?" What do you think?