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# Just Tell Me The Rules! Or When Did The Rules Change?

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# The Case Association

## PROCEEDINGS OF "CASES IN PROGRESS" 2004

Vice President - Publications & Proceedings Editor  
Linda Richardson, Siena College

Associate Editor  
James Nolan  
Siena College

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# Thank You

The Case Association wishes to formally acknowledge and thank the School of Business of Siena College for their support of the *2004 Proceedings of Cases in Progress*.

We would also like to thank the Eastern Academy of Management's Program Chair, Eric Kessler and Proceedings Editor Shanthi Gopalakrishnan for all their assistance.

41<sup>st</sup> Annual Meeting  
Providence Marriott Hotel  
May 12-15, 2004

## PREFACE

Linda Richardson,  
Siena College  
Editor  
&  
James Nolan  
Siena College  
Associate Editor

### *2004 Proceedings of Cases in Progress*

The CASE Association (formerly the Eastern Case Writers Association) was founded for the purpose of promoting case research and to develop a forum where new case writers could have their works "publicly" aired and analyzed by recognized experts in the field. The CASE Association also fosters excellence in case instruction by accentuating the value and use of the teaching note in case writing and research. The feedback derived from these open forums has assisted authors in reworking their cases for the purpose of submission to case research journals and has led to actual case publication and classroom use. These unrestricted sessions have also led to fruitful exchanges of techniques and ideas in terms of case instruction.

*Cases in Progress* was developed in 1992 by James J. Carroll, Georgian Court College, to further the mission of The CASE Association by providing an educational workbook for new case writers and case instructors. It represented a departure from traditional conference proceedings in that standard proceedings embody the culmination of refereed and accepted works published for the purpose of information dissemination and increasing the current body of knowledge. Papers published in proceedings are therefore usually considered as complete works and may even lead to future research and publishing in an academic or professional journal.

This electronic proceedings, however, is designed not only for the purpose of assisting authors in developing their cases into publishable works but to help those authors contemplating case research understand the content and methodology of constructing a cogent case and teaching note. The material in these proceedings, therefore, is designed for the purpose of educating case writers in the development of cases and case notes and may not be "ready" for use in teaching, research, or any other purpose except for the study of case writing.

## MISSION & PHILOSOPHY

The CASE Association views itself primarily as a developmental organization. Our mission is to foster case research, writing and instruction; an approach that is "inclusive" rather than "exclusive." We strive to help case writers (particularly beginners and potential beginners) understand more about improving their initial efforts at case research.

Our interest in cases is in the developmental process. For our conferences, we look for cases *in progress*, **NOT** perfect publishable cases. We believe it is better to learn about cases by studying their flaws than by trying to learn from fully developed and completed cases. A submittal that does not require major revision may be rejected from the program. We expect even the most developed cases considered by The CASE Association to undergo further significant revision before being submitted for publication in another case publication outlet. On the other hand, all cases submitted must be sufficiently formed to enable constructive criticism.

The CASE Association's conference VIP panels and "embryo" roundtables aim to help both the authors of cases discussed and those in attendance to better understand what should be in a good case and its teaching note; by demonstrating the editorial process at work.. The cases are discussed in open roundtable sessions with a view to identifying strengths, weaknesses and ways of improving the case for "publication" and instruction.

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# PRESIDENTS LETTER

Dear Colleague –

Welcome to CASE 2004!

CASE is a developmental organization. We foster case research, writing and instruction and are inclusive rather than exclusive. We strive to help case writers (particularly beginners) understand more about improving their initial efforts at case research. In order to live that mission, our conference is all about development and growth.

This conference, we are introducing some new approaches to case writing and teaching. If you are interested in embryo cases, we have 15 cases in early stages to share with you. Please participate in helping our authors to take their cases from the idea stage to a full blown case or just come to listen and get suggestions for the development of your own case.

If you are interested in seeing some fully-developed brand new cases and how our reviewers are helping to improve them, come to the “regular” sessions. You will hear some remarkably insightful critiques which you will be able to apply to your own work. If you read the cases and reviews ahead of time, you can bring value to the case session yourself, and the authors will really appreciate that.

Our premier cases are reviewed by our VIP reviewers, Fellows of the CASE Association. This year, they will be presenting consolidated reviews and then turning the cases over to round tables for pedagogical discussions. Come and learn how to teach a case so that it is really effective. Learn how to help your students get the most from the cases you assign them.

In addition, the focus on communication this year has resulted in several exciting developments:

- We have a website, [www.caseweb.org](http://www.caseweb.org)
- We have a newsletter which can be found at the website, CASEletter
- We have a brand new journal, The CASE Journal, to which we invite you to submit your cases and articles about case writing, teaching, and research.

And there's much more to come. We have ideas for new programs, new awards, and new membership activities. CASE is growing and we're glad that you're one of us. Please invite your colleagues to join us and become part of a caring, collegial, and inclusive group of like-minded academics!

Cordially,

*Gina*

Gina Vega  
President



# ANNUAL CONFERENCE - PROGRAM SCHEDULE

## ***THURSDAY MAY 13<sup>TH</sup>***

12:30 – 1:45 pm      **REGULAR CASE SESSION 1**

**Facilitators for Table 1:**

**Cynthia A. Ingols**, Simmons College

***Table 1***

MOMENT OF TRUTH

**Donald H. Schepers**, Baruch College

**Harry Rosen**, Baruch College

MALDEN MILLS INDUSTRIES, INC.

**Christine Salierno**, Hofstra University

**Wayne Grossman**, Hofstra University

DISASSEMBLING THE TEAM AT VANGUARD ELECTRONICS

**Joseph A. Casali**, Empire State College

**Barry Armandi**, SUNY - Old Westbury

**Herbert Sherman**, LIU-Southampton College

**Facilitators for Table 2:**

**Alan B. Eisner**, Pace University

***Table 2***

MANHATTAN BAGEL

**Grace Ann Greenberg**, Georgian Court University

**Carolyn Stumpf**, Georgian Court University

THE BUZZARDS BAY OIL SPILL OF 2003

**Kathleen Suchon**, University of Massachusetts - Dartmouth

***THURSDAY MAY 13<sup>TH</sup>***

**2:00 – 3:15 pm      REGULAR CASE SESSION 2**

**Facilitators for table 1:**

**Donald H. Schepers**, Baruch College

***Table 1***

YMCA OF EAST BOSTON

**Cynthia A. Ingols**, Simmons College

**Jamie Ladge**, Boston College

THE TRUTH THAT EVERYBODY KNOWS?

**Mary G. Trefry**, Sacred Heart University

ANALYZING THE TIME MANAGEMENT OF EXECUTIVES IN POST-SOVIET AREA  
(BELARUS)

**Yuliya V. Ivanova**, Central Connecticut State University

**Margaret E. Mitchell**, Central Connecticut State University

**Facilitators for table 2:**

**Barry Armandi**, SUNY - Old Westbury

***Table 2***

ATARI AND INFOGRAMES ENTERTAINMENT SA

**Carlito Cabelin**, Pace University

**Alan B Eisner**, Pace University

SPECIALIZED FINANCE GROUP #1

**David Prottas**, Baruch College

SEGWAY: A NEW DIMENSION IN HUMAN TRANSPORTATION

**Alanna Tracy**, Pace University

**Alan Eisner**, Pace University

***FRIDAY MAY 14<sup>TH</sup>***

**8:30 – 9:45 am      HOW TO WRITE A CASE-WORKSHOP**

**FACILITATOR**

**Gina Vega**, Merrimack College

**PANELISTS**

**Bill Naumes**, University of New Hampshire

**Margaret Naumes**, University of New Hampshire

**John Seeger**, Bentley College

**Herbert Sherman**, Long Island University

***FRIDAY MAY 14<sup>TH</sup>***

**10:15 – 11:45 am      EMBRYO CASE WORKSHOP *Table 1***

**Facilitators for table 1:**

**Margaret Naumes**, University of New Hampshire

**Donald H. Schepers**, Baruch College

**LEADING AND LEARNING: KRISTENN EINARSSON AND THE NORWEGIAN BOOK CLUB**

**Jack McCarthy**, University of New Hampshire

**ETHICAL EROSION AT WINDSWEPT FARMS**

**Carol Cabrey Cirka**, Ursinus College

**Carla M. Messikomer**, The Acadia Institute

**CORPORATE SOCIAL RESPONSIBILITY IN THE BRAZILIAN**

**Norman de Paula Arruda Filho**, ISAE/FGV

**Hsu O'Keefe**, Pace University

**Linda M. Sama**, Pace University

**Cintia Takada**, ISAE/FGV

**LEVERAGING ORGANIZATIONAL WISDOM TO EFFECTIVELY RESPOND TO MARINE OIL POLLUTION**

**Paul S. Szwed**, U.S. Coast Guard Academy

**KIJA KIM, PRESIDENT AND CEO, HARVARD DESIGN AND MAPPING, CAMBRIDGE, MA**

**Lynda L. Moore**, Simmons College

**Bonita L. Betters-Reed**, Simmons College

## ***FRIDAY MAY 14<sup>TH</sup>***

**10:15 – 11:45 am      EMBRYO CASE WORKSHOP *Table 2***

### **Facilitators for table 2:**

**Bill Naumes**, University of New Hampshire

**Barry Armandi**, SUNY - Old Westbury

### WACHOVIA CHAMPIONSHIP

**Tim Burson**, Queens University of Charlotte

**Lester Hudson**, Queens University of Charlotte

**David Rudd**, Queens University of Charlotte

**William Sparks**, Queens University of Charlotte

### JUGOS TROPICALES

**Steven F. Freeman**, University of Pennsylvania

### BUSCANDO POR AMIGOS EN MEXICO (LOOKING FOR FRIENDS IN MEXICO)

**Paul M Swiercz**, George Washington University

**Pramila Rao**, George Washington University

### DISTRICT OF COLUMBIA PUBLIC SCHOOLS

**Deborah A Smith Cook**, George Washington University

**Kimberly Edelin Freeman**, George Washington University

## ***FRIDAY MAY 14<sup>TH</sup>***

**10:15 – 11:45 am      EMBRYO CASE WORKSHOP *Table 3***

### **Facilitators for table 3:**

**John C. Byrne**, Pace University

**John Seeger**, Bentley College

**Carolyn Stumpf**, Georgian Court University

### JUST TELL ME THE RULES! OR WHEN DID THE RULES CHANGE?

**Valerie Christian**, Sacred Heart University

### THE PERSONAL HEALTH DIARY

**Gil Brookins**, Siena College

### AN AMERICAN UNIVERSITY IN RUSSIA

**Geraldine A. Kisiel**, Central Michigan University

### THE AUTO INSURANCE INDUSTRY AND AUTO BODY SHOPS: CAN THE SHOPS SURVIVE IN THE ERA OF "DIRECT REPAIR?"

**Robert Alexander Herring**, Winston-Salem State University

**Janice Witt Smith**, Winston-Salem State University

***FRIDAY MAY 14<sup>TH</sup>***

**10:15 – 11:45 am      EMBRYO CASE WORKSHOP *Table 4***

**Facilitators for table 4:**

**Gina Vega**, Merrimack College

**James Carroll**, Georgian Court University

**MIKE'S APARTMENT CRISIS**

**Munehiko Matsuyama**, Baruch College

**D & H MANAGEMENT, LLC**

**Herbert Sherman**, Southampton College -L.I.U

**Daniel J. Rowley**, University of Northern Colorado

**COLLIER COLLEGE NEEDS TO DECIDE**

**Frederick J. DeCasperis**, Siena College

**THE GREATER WASHINGTON EDUCATIONAL TELECOMMUNICATIONS ASSOCIATION, INC.  
(WETA)**

**Joel W. Cook**, George Washington University

**Deborah A. Smith Cook**, George Washington University

***FRIDAY MAY 14<sup>TH</sup>***

**1:45 – 3:00 pm      VIP CASE SESSION**

**VIP Panelist**

**James Carroll**, Georgian Court University

**John Seeger**, Bentley College

**Timothy Edlund**, Morgan State University

**LACTEOS DEL PACIFICO**

**Steven F. Freeman**, University of Pennsylvania

**DOT.COM VERSUS DOT.BOMB: THE STRATEGIC CHALLENGES OF STARTING AN E-BUSINESS**

**Robert A Page**, Southern Connecticut State University

**Edward H. Hernandez**, California State University

**CAREER DILEMMAS: WOMEN FACING DIFFICULT CHOICES**

**Cynthia A. Ingols**, Simmons College

**Mary L. Shapiro**, Simmons College

**RETENTION AT FLEETBOSTON FINANCIAL**

**Michael E. Johnson-Cramer**, University of Massachusetts, Boston

**Fred K. Foulkes**, Boston University

***FRIDAY MAY 14<sup>TH</sup>***

**3:30 – 5:00 pm      REGULAR CASE SESSION 3**

**Facilitators for table 1:**

**Jack McCarthy**, University of New Hampshire

**Table 1**

SHIPYARD BREWING COMPANY: OFFLOADED IN A ZERO GROWTH INDUSTRY

**Thomas C. Leach**, University of New England

SONY ONLINE ENTERTAINMENT: EVERQUEST OR EVERCRACK?

**Gina Vega**, Merrimack College

**Judith W Spain**, Eastern Kentucky University

VECOSA (VEGETALES CORTADOS, S.A.)

**Steven F. Freeman**, University of Pennsylvania

**Facilitators for table 2:**

**David Edouard Desplaces**, University of Hartford

**Herbert Sherman**, Southampton College -L.I.U

**Table 2**

APPLE COMPUTER INCORPORATED: HARDWARE & SOFTWARE SEGMENTS OF THE COMPUTER INDUSTRY

**Swan D. Suseno**, St.John's University

**Robert J. Mockler**, St.John's University

**Marc E. Gartenfeld**, St.John's University

**Mary Elizabeth Moran**, St.John's University

100 YEARS OF FORD: FROM DOMINANCE TO DEATH?

**Naga Lakshmi Damaraju**, UT Dallas

**John C. Byrne**, Pace University

**Alan B. Eisner**, Pace University

***FRIDAY MAY 14<sup>TH</sup>***

**5:00 – 6:30 pm**

**CASE BUSINESS MEETING**

*Presiding: Gina Vega, Merrimack College*

## ***SATURDAY MAY 15<sup>TH</sup>***

**9:00 – 10:15 am      REGULAR CASE SESSION 4**

### **Facilitators for table 1:**

**Steven F. Freeman**, University of Pennsylvania

**Michael E. Johnson-Cramer**, University of Massachusetts, Boston

### ***Table 1***

HUNTING FOR BAMBIE

**Leslie A Korb**, University of Nebraska at Kearney

DELL COMPUTER CORPORATION: COMPUTER HARDWARE INDUSTRY

**Murad Kuliye**v, St.John's University

**Robert J. Mockler**, St.John's University

**Marc E. Gartenfeld**, St.John's University

**Mary Elizabeth Moran**, St.John's University

WHAT HAVE I LEARNED?

**William E Matthews**, William Paterson University

**E.J. Roy Knaus**, William Paterson University

REVISITING DOING BUSINESS IN THE MIDDLE EAST

**David Edouard Desplaces**, University of Hartford

**Nancy H Leonard**, University of West Virginia

### **Facilitators for table 2:**

**Robert A Page**, Southern Connecticut State University

**Thomas C. Leach**, University of New England

### ***Table 2***

BISLERI: MUDDLING THROUGH CHOPPY WATERS

**Rahul Gupta**, Indian Institute of Management Lucknow

**Bharat Aggarwal**, Indian Institute of Management Lucknow

**R Srinivasan**, Indian Institute of Management Lucknow

WORKFORCE REACTIONS TO MASSIVE CULTURAL SHIFTS: THE CASE OF A  
CHANGED CONSUMER PRODUCTS COMPANY

**Thomas Diamante**, Adelphi University

**MaryAnne McCormick Hyland**, Adelphi University

SUSPENDED BETWEEN A ROCK AND A HARD PLACE: LAUNCHING IT  
INTERACTIONS IN TIME AND SPACE IN AN EMERGING GLOBAL BUSINESS

**B. Elisabeth Rossen**, University of Oslo

# ANNUAL MEETING -ROUNDTABLES

## SESSION FORMAT

Rather than use traditional front of the room presentations followed by relatively little author and audience interaction, The CASE Association will use a roundtable discussion format for our annual meeting sessions.

After a case has been accepted for the conference, the case is distributed to a small group of designated discussants and case writers whose cases have also been accepted. Usually these groups, which are formed around similar case subjects or topics, consist of several assigned participants in addition to anyone at the conference that 'drops in' on that table session as an observer. This is in the interest of balancing the level of preparation and spontaneity of each roundtable.

## Case Presentations and Discussions

Participants and observers may take part in the case critiques and discussions. Participant members have the responsibility of reading and critically evaluating all the cases in their table session so that during the meeting they can make constructive and useful recommendations for the improvement of the cases presented.

The case sessions run about 75 minutes. A case writer will be asked to give a very brief overview of his/her case. This is followed by the other participants and observers seated at the table giving comments and suggestions, on how that particular case might be improved for future use and publication. This process continues until all cases have been presented and discussed. The emphasis is on constructive comments and suggestions during these sessions. Critiques should be presented with the understanding that the end goal is to develop stronger cases and that positive criticism yields more productive results for all.

## Participant Responsibilities (Case authors and Discussants)

Read and prepare comments, critiques, and suggestions for ALL of the cases at your assigned table for your assigned session PRIOR TO ATTENDING THE CONFERENCE. Simply, if everyone is prepared, then everyone benefits all the more from the interaction.

Preparing a case for discussion is a critical exercise that requires you to look at the case with a narrowed eye and a constructive mindset. You can either prepare your notes on a separate page to give to the case author at the conclusion of the round table, or you might prefer to make your notes directly on the printed case and teaching note, copies later to be given to the case author to make revision easier. Since people are likely to focus on different parts of the case and teaching note, don't worry about being repetitive; if it's important, it's important to hear multiple times.

When preparing your review, think about what you would like to know about your own case.

- Is it readable?
- Does it grab the reader's interest and hold it?
- Is there an identifiable problem?
- What level student is the case best for?
- Is there enough information in the case to perform a thorough analysis?
- Does the TN provide a good discussion of relevant theory?
- Will it make the instructor's life easier?



- Can the questions be answered from the case or is more research necessary?
- Is the case connected to the most commonly used texts in the topic area?

And remember to offer compliments as well as criticisms. We all like to hear what is especially appealing about what we write.

A Round Table review process is a learning experience, both for authors and for reviewers. Your preparation will make it a valuable learning experience.

## THE CASE ASSOCIATION - OFFICERS

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## REVIEWERS FOR 2004

Srinivasan R-Indian Institute of Management Lucknow  
Cynthia Ingols-Simmons College  
Deborah Smith Cook-George Washington University  
Linda Hartenian-UW Oshkosh  
Gil Brookins-Siena College  
Raymond Lopez-Pace University  
Carol Cirka-Ursinus College  
Charles Drexel-Southampton College  
Michael Johnson-Cramer-University of Massachusetts, Boston  
**David Prottas\*-Baruch College**  
E. J. Roy Knaus-William Paterson University  
Valerie Christian-Sacred Heart University  
Wayne Grossman-Hofstra University  
Patrick Hibbeler-Saint Ambrose University  
Lynda Moore-Simmons College  
Jeannette Oppedisano-Southern Connecticut State University  
Mary Elizabeth Moran-St Johns University  
Victor Henning-The WHU – Otto Beisheim Graduate School of Management  
Steven Freeman-University of Pennsylvania  
James Carroll-Georgian Court College  
Alan B. Eisner-Pace University  
Shripad Pendse-St. Marys University  
Tim Edlund-Morgan State University  
**Carolyn Stumpf\*-Georgian Court College**  
Barry Armandi-SUNY Old Westbury  
Leslie Korb-University of Nebraska at Kearney  
**Linda Sama\*-Pace University**  
G. Erickson-Ithaca College  
Stephen Morreale-Worcester State College  
MaryAnne Hyland-Adelphi University  
**Herbert Sherman\*-Southampton College**  
Munehiko Matsuyama-Grad. Center/Baruch College - City University of New York  
**Gina Vega\*-Merrimack College**  
Harry Holt-George Washington University  
Bonita Betters-Reed-Simmons College  
David Desplaces-University of Hartford  
Mary Trefry-Sacred Heart University  
**John Byrne\*-Pace University**  
Jill Woodilla-Sacred Heart University  
Thomas Leach-University of New England  
**Donald Schepers\*-Baruch College**  
Margaret Mitchell-Central Connecticut State University  
Jack McCarthy-University of New Hampshire  
Kathleen Suchon-University of Massachusetts Dartmouth  
Robert Page-Southern Connecticut State University

### \* Outstanding Reviewer Awards

## VIP CASES

## **Career Dilemmas: Women Facing Difficult Choices**

Cynthia A. Ingols, Simmons College - [cynthia.ingols@simmons.edu](mailto:cynthia.ingols@simmons.edu)  
Mary Little Shapiro, Simmons School of Management - [jtshapiro@aol.com](mailto:jtshapiro@aol.com)

*Presented at the VIP session of the Case Association 2004 Meeting*

Keywords: career, women, difficult choices

### **ABSTRACT**

Three women protagonists faced three different career decisions. One protagonist needed to decide if she should stay in an organization where she felt comfortable or move to a more prestigious firm. The second protagonist wondered how to turn down a promotion without getting sidelined. And the third actor grappled with how to deal with a corporate environment seemingly hostile to women.

---

### **How cases are used:**

The authors use these cases in an executive education program designed for women who are sent by their companies to attend a week-long leadership course. The intensive nature of the leadership program encourages faculty to assign short, compelling cases. The discussion of these cases is on the last day of the program in a session titled "Managing One's Career." The discussion lasts approximately ninety minutes.

### **LAURA'S CASE:**

In 2001 Laura graduated from business school with a MBA. She and her finance, both in their twenties, moved from Atlanta to Dallas to allow Tom to join a prestigious law firm as a junior associate. Laura, a specialist in human resources, found the job market tight in Dallas. After job-hunting for several months, she landed a position in a boutique executive search firm. The firm was started by three women partners who very much believed in supporting and promoting women. In fact, one of the women partners had written a best-seller about successful women and how they managed their careers.

During the past two years Laura has learned the recruiting business. As an associate she conducted research for the company's three partners, interviewed perspective clients for the first elimination round, and attended client meetings with the partners. The partners talked with her about how she might become a partner someday.

As 2003 ended, the executive recruiting business was gaining steam and Laura's reputation had grown in the industry. Recruiters from larger, better-established, better-known firms were calling Laura and asking her to apply for positions within their firms. One firm offered Laura the same amount of money that she was making. When Laura tried to negotiate a large bonus to match the bonus that was due to her at the end of 2003, the negotiations fell apart.

Now once again Laura didn't know what to do since she had another job offer on the table. She really liked her current firm, its work environment, the people, and their values. "I can't imagine a better environment in which to work," Laura said. However, she was being offered the opportunity to join a well-known executive recruiting firm. This one demanded such respect in the industry that potential clients returned calls immediately. In contrast Laura knew that many people did not know her present employer and consequently, their phone calls sometimes went unanswered or were returned slowly.

Laura pondered her choices. Should she stay with her present employer with whom she felt comfortable, supported, and able to negotiate a reasonable integration of her work and personal life? Or should she take the job with the prestigious firm with approximately the same money and a boss from whom she thought that she would learn a lot? Laura noted: "My visibility within

the industry, my potential to network with high level executives, and my opportunity to sit at the table and observe high-level searches is great with the new job. On the other hand, I like my present job!”

### **MICHELLE’S CASE:**

Michelle received her MA in Library Science and began work at a prestigious New England college ten years ago. She quickly advanced to becoming the Director of Information Services, reporting to the Executive Director of the Library, and sitting on the powerful senior administrator committee, which determined operating policy and budget for the College.

Melissa’s staff totaled over 20, half of which were librarians responsible for conducting research for faculty, students and visiting scholars. The other 10 were assistant researchers responsible for helping students with research, and serving as first line triage gatekeepers for the librarians.

A year ago the library began huge renovation, involving the entire collection and operation moving to alternative sites for a projected 2 year period. Six months ago the Executive Director of the Library, at the request of the College President, temporarily moved into a position managing special projects for the college, and Michelle accepted the offer to become Acting Executive Director. During those six months, two things occurred. One, Michelle successfully managed the off-site operations, and began rigorous planning for the transition back into the renovated library. Two, the Executive Director decided not to return to the helm of the library.

Two weeks ago, the President’s Council of College Deans and Vice Presidents asked Michelle to become the official Executive Director of the Library. When Michelle hesitated and said, “I need to think about it” they were stunned. The President exclaimed, “Don’t you realize what a



prestigious position this is? People wait a lifetime for an opportunity like this. I thought you were interested in a career here.”

Michelle has a week to respond. She knows she can do the job, but she is concerned about what opportunities will be *cut off* by accepting the position. She has long been interested in expanding her technical capacity and exploring cutting edge developing technology. She wanted to return to her Director of Information Services job where she could continue to work in areas she’s passionate about.

Michelle wrestled with many questions, central of which was: how to say no and not have her career sidelined? How to say no and still maintain her relationships with and her ability to influence the senior administration?

#### **SHERRY’S CASE:**

Sherry has worked for small start up pharmaceutical company for 6 years as the Director of HR. When she started with them there were 40 employees; a year ago their drug was FDA approved and the company has since ballooned to 300 people. Sherry had always reported up through the CFO, but as the company grew, she wanted to become a VP, and report to the CEO. However, she remained as a Director, feeling that her contributions of fostering a collaborative corporate culture, hiring talented people, building relationships were never adequately recognized.

When the drug was approved the CFO decided to replace the senior line with new people. Sherry disagreed, exclaiming, “You can’t just *fire* people.” However, the CFO and CEO did. All the new VPs were young men (COO-39, CEO-45, general counsel-33) with stay-at-home wives.

The senior culture crystallized into one about aggression, fighting for control and territory, and winning. Sherry's style of collaboration and collegiality was not understood. At one meeting where she made a proposal the CFO said, "Let's meet again and argue about this." She countered with, "Why not just talk about it and decide what's best for the company?" He looked at her questioningly.

A couple of events prompted Sherry to think seriously about her next career steps. First, Sherry made a two-hour budget presentation to the 14 VPs and Directors where she felt she was "well prepared and on top of my game. I could dish it out as fast as they dished it to me." Afterwards, many people complimented her, but the CEO said, "You were a little *sharp*."

The second event occurred when she asked yet again to become a VP. The CEO told her, "You're not a VP because you're not in alignment with us." Sherry returned to her office dejected and pondered her options.

Part of her wanted to leave the company. She anticipated that the company would give her a good severance package since she was needed to testify in a lawsuit brought against the company by one of the senior managers who was terminated by the CFO and CEO. A sizeable severance package would allow her to "recover from this job and then look for another one."

Another part of Sherry wanted to stay and fight for the title and position of VP of HR. Since Sherry had been with the company from its earliest days, she had designed and implemented all of its HR policies. In the early days she had personally screened and hired most of the talented

people that now populated the company. And Sherry disagreed with the aggressive culture that encouraged shouting at one another and putting people down. She liked and respected many of the people that worked at the company; certainly they deserved a better work environment than the current direction of the company. Sherry wondered what she should do.

## **Career Dilemmas: Woman Facing Difficult Choices**

### ***Instructor's Manual***

#### **Case Synopsis:**

Three women protagonists faced three different career decisions. Laura, comfortable in her current position at an executive search firm started and run by women partners, was offered a job with greater visibility at a well-known firm. However, the money was no greater. Michelle, on the other hand, followed her passion and turned down an executive director's position at a prestigious library to remain director of information services. She now wondered how she would remain influential in the organization and how she would continue her career advancement and traction. The third protagonist, Sherry, encountered her own tough career decisions. She had been director of human resources at a small pharmaceutical company for six years. During the past year with the addition of new leaders at the top of the organization, the work environment changed from collaborative to aggressive. Additionally, Sherry's request to become a vice president and to have a seat at the table was denied by the CEO. Sherry needed to decide between negotiating for a large severance package or staying to fight another day for what she believed.

#### **Intended course and positioning of cases:**

The authors use these cases in an executive education program designed for women. Women from major corporations are sent by their companies to attend a week-long program on leadership. The last day of the program is devoted to discussions and decisions about how the participants intend to advance their careers when they return to their home organizations. Since most of the participants are in their thirties and forties, issues about how to balance work and personal life are always a topic of interest and concern.

The intensive nature of the women's leadership program encourages faculty to assign compelling, short readings. Hence these concise cases are used. The discussion of these cases lasts approximately ninety minutes.

The purpose of these three short vignettes is to invite participants to examine several career decisions faced by women. The overarching learning objective for these cases and the discussion is: "You are responsible for managing your career." To set the stage for these discussions, participants read Peter Drucker's article, *Managing Oneself* (Drucker, 1999). Drucker argues that corporations no longer take charge of people's careers. Instead, each manager and executive is responsible for her work life.

#### ***Theoretical Underpinnings for Career Cases:***

There are two strands of research and books that support the importance of the use of these vignettes in discussing career options with managerial and executive women. The first deals with general career advice, regardless of gender. In 1989, Kanter argued that the changing nature of work, such as project-oriented teams, flatter organizational hierarchies within corporations,

meant that careers and how people experienced their work lives would radically change in the decades ahead.

Two recent books support Kanter's message and give practical advice about how to manage one's career. In 1995 David Helfand wrote an advice book for those who wanted to change their career direction. Not surprisingly, Helfand's overall advice is "to take control of your career." Helfand sets his discussion of career changes in the context of adult development literature. He draws upon the work of such well known developmental theorists as Erik Erikson and Daniel Levinson to argue that each age and stage of development requires adults to accomplish certain life tasks. Finding work that is compelling and meets one's developmental needs is one of Helfand's central messages. Once the author established a strong theoretical underpinning for this book, he proceeds to give practical information about managing one's work life.

In 2003 O'Connell published *The Career Survival Guide*. This author pushes readers to face the global, fast-paced world of today and argues that these trends will accelerate. Like Helfand, O'Connell's overarching advice is for the readers to take charge of their careers today to survive tomorrow. Since the late 1980s, then, the thrust of writers' advice is: don't wait for a boss, human resource specialists, or the company to advance your career. Instead, set your own path.

This advice imposes a burden upon people to know their strengths (Drucker, 1999) and their values (Waldroop and Butler, 2000). Drucker (1999) argues that career management requires that people manage themselves, knowing their strengths and how to develop them. Waldroop and Bulter (2000) argue that all people work for rewards but that the rewards that people seek are strikingly different. While some values are personality driven, such as the need for autonomy, others may shift as life circumstances change. For example, the drive for security is often a low priority for a single, twenty-something and high for a forty-something, married with children (pp. 233 – 240). Knowing one's strengths and how to develop them and clearly articulated values are essential ingredients to managing one's career.

The second strand of research is captured in literature on women's careers. Fletcher, Rappaport, Bailyn, and Pruitt (2002) argue that many of the career dilemmas women (and increasingly men) face in organizations is due to outdated but firmly ensconced "rules for success" and definitions of competence and commitment. While any employee would suffer from the burnout and stress created by working 80 hours a week, it remains particularly problematic for women. First, the very "rules for success," primarily written by middle-class white males, include language that is culturally seen as masculine: to be successful you must be competitive, autonomous, assertive, and heroic.

The definition of competence itself is also gendered. The rules for demonstrating competence at work are closely aligned with idealized images of men and masculinity: you must be individualistic, authoritarian, and self-promoting. This creates several dilemmas for women. The first is the classic "double bind:" if a woman doesn't follow the masculine characteristics she's not see as "tough or assertive" enough, key attributes for landing plum assignments and consequently moving up the career ladder; on the other hand, if she does follow them, she may seem as arrogant or a witch, again to the detriment of her career (p. 33). Second, oftentimes "real work" and "valued skills" in organizations singularly emphasize technical capability.

Other skills, such as team building, conflict resolution, or collaboration, are often referred disparagingly as “people skills.” It is often those “people skills” that women bring to the organization, skills that are often not valued, and thus not rewarded.

Finally, the male-written definition of commitment precludes any interests outside of work. The authors argue that “the definition of commitment remains rooted in a traditional concept of the ideal worker as someone for whom work is primary, time to spend at work is unlimited, and the demands of family, community and personal life are secondary.” Time spent at work is a key indicator of commitment that disproportionately impacts women. Being physically at work for long hours, holding meetings after hours, “doing whatever it takes” (involving weekend work or all-nighters) are all ways of showing commitment. Anyone (male or female) who has outside-of-work responsibilities is disadvantaged.

So what are women to do? Fletcher, Rappaport, Bailyn, and Pruitt state that negotiating individual arrangements (such as flex time, compressed work week, time working virtually, job share) is inadequate: “...the powerful cumulative effect of these individual solutions is to reinforce the societal dictum about individual choice: which is more important to you, work or personal life?” (p. 39). And presently that choice is largely seen as belonging uniquely to women. Fletcher and group argue that the culture of the organization must change to one beyond work-life *balance* to one of work-life *integration*. To do that, in addition to managing their careers, women must work at changing an organization’s definition of commitment, competence, and success. They can do this by challenging current definitions, labeling them, and pointing out their meaningful work contributions while working with different definitions.

Another women’s literature perspective is the work done by Fletcher, in *Disappearing Acts: Gender, Power, and Relational Practice at Work* (1999). Fletcher argues that while organizations say that they want collaboration and supportive teamwork “people who exhibit such behavior seem to *get disappeared* from the organizational screen” (p.3) She coins the verb “to be disappeared” to describe behavior that is just not invisible to others, or behind the scenes, but is behavior that through an organization’s norms and beliefs is not regarded to have positive impact or contribution. The behavior is seen (so not invisible) but is *disappeared*. Why? “Not because [the behaviors] are ineffective [in contributing to organizational goals] but because they get associated with the feminine, the relational, or the so-called softer side of organizational practice. This implicit association with the feminine tends to code these behaviors as inappropriate to the workplace because they are out of line with some deeply held, gender-linked assumptions about good workers, exemplary behavior, and successful organizations (p.3).”

Because these relational behaviors (often pejoratively referred to as “people skills”) are conflated with the feminine, (technical skills conflated with the masculine) women are *expected* to perform them. Fletcher argues that society assigns relational activity to women and views it as ‘women’s work.’ We can easily see how this impacts the careers of women.

One impact is that the *value* of the behavior itself is disappeared. For example, a woman team leader goes off-line to act as a mediator to get two members in conflict to work things out. As a result, the project gets completed on time. But instead of being seen as doing what it takes to get the job done, she is seen as “being nice.” She could have just yelled at the two people in a team

meeting to “get along or get out of here.” The value of good conflict resolution skills was disappeared. Going off-line and talking to each person individually might even be seen as gossipy, manipulative, or even worse, acting like “a mother hen.”

What further removes her from being seen as a person having value is that her strategic intention (in this case, getting the project done) is lost. Her “pragmatic, goal-directed purpose to keep the team on track is obscured. Instead, she is seen as acting on her natural tendency to be nice or to care about people” (CGO Insights, *Invisible Work: The Disappearing of Relational Practice at Work*, p. 2).

Finally, engaging in relational behaviors also puts women at risk of being seen as feminine, and consequently not a leader. For example, men who roll up their shirtsleeves, get in the trenches, do whatever it takes to get a job done are seen as hands-on leaders. Women who do the same behavior are seen as micromanaging or nitpicking or “mothering.”

Behavior that is disappeared does not get rewarded, even while its positive contribution helps the organization reach its goals. Women’s relational behaviors get disappeared as women are expected to perform them, or as the behaviors get separated from the strategic intent and are not seen as performance driven. And yet, women’s relational behaviors are often in line with what organizations often say they need (and actually do need): the “new worker” who fosters teamwork and collaboration, thinks about what’s good for the entire system not just what’s good for themselves, or shares information and expertise. Unfortunately, organizations still often reward, and so promote the worker who plays by the old rules and the old definitions. “The workplace benefits from this relational way of working but does not change its norms about valuable work, valuable workers, or promotable behavior” (CGO Insights, *Invisible Work: The Disappearing of Relational Practice at Work*, p. 3).

### **Research Methodology**

As part of a larger study on careers, the authors have interviewed twenty women. The authors interviewed the three women case protagonists as part of the study. The identities of the women protagonists have been disguised.

### **Assignment for student preparation:**

Reading assignment:

- Drucker, P. “Managing Oneself,” *Harvard Business Review*, Sept-Oct, 1999.
- Peters, T. “The Brand Called You,” *Fast Company Magazine*, Sept-Oct, 1999.
- Fletcher, J. “Invisible Work: The Disappearing of Relational Practice at Work,” CGO Insights, March 2001

Study questions:

1. What should Laura do? Take the job with the prestigious name or stay in her comfortable current position?
2. Michelle has made her decision not to take the promotion. Now, how does she continue to advance her career at this organization?
3. What should Sherry do? Leave a company that no longer reflects her values, or stay and help to change the organizational culture and its values?

## Teaching Plan

### Discussion Questions and Answers

The format for each case discussion roughly follows:

- What is the situation? What are the underlying dynamics, causes, and dilemmas?
- What should the protagonist do?
- What did we learn about our own career management?

Discussion of Case #1: Laura

#### **1. How would analyze the career risks for Laura of staying in her present position *and* the risks of moving to the new firm?**

If Laura stays in her present job and organization, she runs the risks of not dramatically expanding her network and her knowledge of her field. *Who* she knows as well as *what* she knows are both important ingredients in career success. In the executive search industry, it is particularly important that Laura expand her contacts. In addition, each executive search firm has its own nuanced methods for conducting placements. It is important for Laura to learn the industry as broadly as she can and taking a job at a prestigious firm would deepen her knowledge of the field.

On the other hand, if Laura takes the new job in the prestigious firm, she runs the risk of not liking the work environment as much as her current firm, of needing to devote longer hours to her job, and of not having such a comfortable relationship with her boss. If Laura finds herself as a “fish out of water,” then she might not be successful in the new firm. In fact, since Laura’s values are in alignment with her present bosses and the work environment, there is a good chance that the new firm will present Laura with conflict and tensions. Currently Laura feels comfortable and nurtured by the partners. The women partners encourage a work/personal life balance that suits Laura. The partners are talking about promoting Laura to partner, a step that is further down the road in any other search firm.

#### **2. What would you advise Laura to do?**

Participants often speculate about how important work-life integration is to Laura at this point in her career. Many note that she is presently single and that this is the point in her career to expand her network and gain greater visibility and knowledge of the industry.



Other participants believe that organizational fit is the critical ingredient to career success and Laura clearly “fits” in her current organization. These folks are loath for Laura to give up a work environment that actively encourages and promotes women. The discussion can include what Laura knows of this next organization’s culture, what she yet needs to find out, and how could she go about discovering those the norms and values during the interview and negotiation process.

On the whole, however, participants find that Laura expresses more enthusiasm for the new job than old and that she should take the new one.

### **3. What are the learning takeaways for your career?**

- It is important to assess the risks of staying *and* leaving when considering a job offer.
- Our choices have consequences. We need to be able to articulate what is most important to us at different points in our careers and the long-term implication of choices. Making a lateral move to increase one’s visibility, networks, and developmental opportunities is important if one most values career advancement. If, however, one wants work-life balance, comfort, and encouragement, then one should voice that choice. When making choices, one needs to consider the possible consequences five to ten years hence.
- Organizational fit is also a key ingredient to professional success. Being successful in one organization isn’t a full predictor of success in another. It is critical to know what dynamics, norms, and values enable you to be successful. Then when considering a move to another organization, identify whether this next opportunity has the components which will enable you to be successful there.

Discussion of Case #2: Michelle

#### **1. What might have prompted the shocked reaction of the President when Michelle turned down the offer?**

Some women will think Michelle is crazy to pass up the opportunity. They question whether Michelle is just shrinking from a stretch assignment and wants to stay in her comfort zone. Quickly this discussion typically turns to gender. Someone will ask, “Would a man turn this assignment down? No way would he.” Students will explain how they’ve seen men and women react differently to an offer involving a stretch assignment or job. Women will more likely say “no” because they know they do not currently have the full skill set to do it. Men will more likely say “yes” and understand that they will find the resources and support needed to be successful in the job.

More nuanced is the issue around how men and women may have different reward values driving their career decisions. Seeing a promotion as the next logical step of Michelle’s career follows the male definition of career progression: linear to the top. Of course the President would be shocked, because clearly he’s followed that linear path to the top of the college. His reward values may be achievement, advancement, authority, competition, fame. He doesn’t recognize that there may be other reward values that are operating for Michelle. These may be challenge, competency, creativity, knowledge.

What's important is that Michelle understands her own reward values, and makes decisions that are consistent with them. These reward values are listed in *The 12 Bad Habits* book but can also be identified through a quick class discussion answering the question: Why do people work? The list usually includes: achievement, affiliation, power and control, challenge, learning and growing, enjoyment, recognition, making an impact, order and structure, self-respect, self-actualization, and money (for paying the bills, future security, lifestyle, supporting dependents, independence, power and influence, measure of success). We often will ask women to think about their own reasons for working, identify their own reward values, and examine to what extent their current job provides those rewards.

**2. How could Michelle say “no” but not get sidelined from future career opportunities and from becoming disengaged in the power structure of the organization?**

Responses may initially focus on telling the President how the position doesn't meet Michelle's needs, and trying to get the President to understand Michelle's goals for her career. Eventually the focus will shift (or we help it shift) to what's good for the organization. The “no” has to be based on how Michelle can make her greatest contribution to the organization. Share what she plans to do (and contribute) as the Director of Information Services, name the challenges that are yet to be resolved, what problems she wants to tackle, and what opportunities she wants to exploit. Other suggestions include leaving the window open by giving a time frame or condition for when she would be ready to move (“...maybe in 2 years...” or “...once I get this service launched...”). And then continue to do a sterling job and make sure people know of your accomplishments so you stay on their radar screen for future possibilities. It is important that what Michelle *shouldn't* do also come out: don't talk about how you don't have the skill set or the experience, don't talk about how you don't think you could do the job, etc.

This is also a good place to discuss how Michelle could accept the offer. If the Executive Director position was in line with her reward values, then what could she do to still meet her goals of expanding her technical capacity? Could she negotiate for time/space to pursue those goals (which also will benefit the library)? The larger discussion then evolves to how to *accept* a job offer and get what you need to meet your own reward values and to be successful. Say “yes, but this is what I need to be successful in the position...” and negotiate for what you need: support staff, coaching, training, budget, reporting structure, access to people or information, etc.

Often the conversation expands to how to say yes, but negotiate for the work-life balance you are trying to maintain. Participants usually agree that you must be positive and proactive (“yes, I can do it, but only if I can work 1 day at home a week”) versus negative and passive (“yes, but I'm worried about the extra time it will take me away from my family”). Don't present work-life balance as the deal breaker. Instead, include solutions that make it work for you.

**3. What are the learning takeaways for your career?**

Typical responses include:

- When offered a stretch assignment, always ask yourself the tough question: “am I saying no because I want to stay in my comfort zone?”
- Don’t let others define your reward values. You must know what will make you happy in your job. Don’t accept a job because it offers reward values that make sense to others.
- Negotiate for what you need to be successful in the position or project you are being asked to take on.

### Discussion of Case #3: Sherry

#### 1. **Why do you believe Sherry has not been made a Vice-President?**

Initially the discussion centers on the CEO’s comment about Sherry not being in alignment with the rest of the group. The participants often point out how Sherry is different from the other VPs: she’s the only woman, she’s the only senior person who survived the CEO-CFO purge of senior management, and she works collaboratively rather than aggressively. The lack of alignment focuses on how she’s different, particularly in her work and communication style. Difference can breed distrust and misinterpretation. Even when she follows the conventional wisdom in dealing with diversity by labeling her different behavior and clarifying her intentions (ie, “Why not just talk about it and decide what’s best?”) she is still misunderstood.

Sometimes participants wonder if the CEO sees Sherry as disloyal, dating back to her challenging him about firing people. To him, that incident may have been a marker that put her in the opposing camp. Challenging a CEO is risky anytime, but there are ways that it can be done without having your loyalty called into question (and consequently your career sidelined). Participant brainstorming on that produces strategies such as: stating the organizational goals you are both interested in pursuing (ie “We both want this company to grow”) to show alignment, voicing your concerns about his plan of action in how it may negatively impact the agreed-upon goals, asking him what he wants to accomplish in taking his proposed action, offering alternatives that enable him to accomplish his objectives while having less negative effects. Do it in private versus in public.

It usually doesn’t take much prodding for the issue of gender to be raised. Once it is, there are many clues that gender dynamics are operating: the CEO calls her “a little *sharp*” after a presentation where she was clearly operating according to the prevailing organizational rules of aggressive combat (“dishing it out”). Tremendous expansion has occurred and she hasn’t been part of it: the company has grown from 40 to 300 people, and the number of VPs now totals 14.

Often we need to introduce the work of Fletcher, Rappaport, Bailyn, and Pruitt to delve deeper into the gender issue that may be impacting Sherry’s career. By asking, “How would the CEO and CFO define a strong VP in this organization?” the discussion is unlocked. Participants quickly list the attributes that the CEO would find critical for a VP: assertive, aggressive, competitive, and competent. (Indeed, this is primarily the way Sherry describes the culture.) The CEO probably wouldn’t list authoritarian, individualistic and self-promoting, but those are also attributes that describe him and the

other VPs. The dilemma for Sherry: those attributes are closely aligned with idealized images of men and masculinity. Not only would the CEO *not* describe Sherry that way (indeed, she wouldn't describe herself that way), he would describe her negatively if she *did* act that way (and in fact he did when he described her as *sharp*). This is the double bind so many women find themselves in: because leadership and competence is conflated with masculinity, women aren't expected to act that way, and are punished if they do.

We also introduce the work of Fletcher around disappearing behavior by asking a series of questions, beginning with, "How would the VPs describe Sherry?" Typical responses include: submissive, wants to be liked, not tough enough, worries about people and not the bottom line. If the CEO describes her that way, why would he promote her to VP? Clearly, he wouldn't. How would Sherry describe herself? Typical responses include: collaborative, cares about people, inclusive, team player, gets people to work well together and take ownership of their work, does whatever it takes to get the job done. Does the CEO see any of that? No. If he sees the behaviors at all, he sees them as weak, or that she has good "people skills" or that she's a good "mother" in the organization. Why doesn't he see those behaviors as helping the organization reach its financial goals?

That question elicits some interesting responses: the CEO and VPs are judging her behavior by their own rules for success which are very different (and so she gets judged poorly); or those behaviors aren't as neatly tied to the bottom line as sales or production. Sometimes participants will see that those behaviors have been devalued because one, they are relational, and therefore conflated with the feminine ("people skills" or "soft skills"), or two, women are expected to perform them and so the assumed behaviors aren't seen, or three, the strategic intent of those behaviors has been lost (she does those behaviors because she "wants to be liked" or she "likes people" instead of doing those behaviors in an effort to make the company be successful).

The bottom line: Sherry's behaviors are making a meaningful contribution to the company's bottom line, but they are not regarded (if they are even seen at all) as doing anything more than making people feel good. Her behaviors (and their contribution) have been disappeared. No wonder she isn't getting a promotion.

## 2. **Should Sherry stay and fight for the title and position of VP?**

The group is usually split on this question, and the side arguing that she should leave increases as the size of the challenge becomes clearer. Many say, "Initially I thought she should stay, until I realized she's not just fighting for recognition, she fighting to change an entire culture."

"So what components need to change for Sherry to ever get that VP title?" we ask. The list is long: the definition of what is a good leader, the list of what behaviors are valued and contribute to the bottom line, the definition of a team player, the belief that competition is a strong motivator for people, all the norms around the company regarding how people should communicate, make decisions, behave at meetings, and handle conflict. Once these are recorded on the board, most participants see the challenge as

totally overwhelming. By asking, “how many of you have faced any one of these challenges?” Sherry’s task becomes much more manageable. Many women have faced one or more of these challenges, and in many cases, were successful in changing definitions, beliefs, and norms.

There is usually much energy brainstorming around how the changes can come about that are necessary for her to get her VP title. The broad themes include:

- Continue to offer alternatives (like her suggestion to the CFO to *talk* about a proposal rather than *fight* about it) and label/name both the new and the old behavior.
- Link all her behaviors to the bottom line. This will make her invisible work visible and valued. When she suggests or models a new behavior, explicitly state how that will positively impact the bottom line. Or explicitly state *why* (the strategic intent) she is doing it.
- Promote her successes: when a collaborative meeting produced an optimal decision, tell everyone about it, and give the collaborative process the credit.
- Recognize the progress will be slow, and be content with what Debra Meyerson in her book *Tempered Radicals* calls “small wins.” The women often share stories of how they have pushed back against aggression, shouting in meetings, hoarding of information and decisions, and have slowly turned behaviors around.

Once it’s established that there are strategies for slowly and incrementally changing the culture, the next question is “*Should* Sherry stay?” Participants frequently point out that women usually stay longer in toxic situations than men, with the often over-optimistic belief that the situation can be changed, or with the self-flagellation that they just need to try harder (“it’s my fault that the situation hasn’t changed, there must be more I can do”), or with an inflated sense of responsibility (and guilt) about leaving others behind in that toxic environment.

Participants suggest that Sherry rigorously analyze her reasons for staying: is it over-optimism, self-flagellation, guilt, altruism, self righteous revenge, or the belief that she can truly make a difference and the commitment to do so? They also want Sherry to explicitly set a deadline for when she will leave if she has not gotten the VP title. Changing a culture is slow work, but she also needs to recognize how that slowness can stall her career. A future prospective employer will look at her resume, see that she was a Director for 6 years, and never got a promotion. That will raise red flags about *her*, not the *company* she worked in.

Recognizing the amount of work it takes to change an entire value system inside an organization, we may ask, “Are there strategies Sherry could do to get the VP title *without* changing the culture?” Some women will say yes, to become a VP she has to play by their rules. Others say no, Sherry’s already been punished by playing by their rules and give the example of the CEO calling her “sharp” when she was clearly aggressive in her presentation. A double standard exists (the men can be aggressive and seen as a leader, a woman is aggressive and seen as a witch) that prevents her from ever being seen as VP material.

The discussion often includes two final topics. One, the issue around blame. Usually a participant will state how when a woman doesn't get the promotion she blames herself and when a man doesn't get the promotion he blames the system. Certainly there is plenty of research around how when women are successful they point outward ("it was easy, I had help, I was lucky") and when they aren't successful they point inward ("I tried, I gave it my all, but I couldn't do it"). When men are successful they point inward ("I'm good, I can do this") and when they aren't successful they point outward ("you didn't give me the resources, I didn't have enough time, you didn't tell me about that"). How does that impact careers? Women stay longer ("if I only try harder") and men leave for organizations in which they'll have a greater chance of success.

Two, feeling overwhelmed at the proliferation of companies that follow masculine models of leadership and rules for success, participants often want some help in finding "women-friendly" companies. Many already have strategies: watch for clues during an interviewing process, examine company websites, look at "top companies for women" lists in *Fortune* and *Working Woman* magazines, and websites about women such as [www.ewowfacts.com/index.html](http://www.ewowfacts.com/index.html).

3. **What are the learning takeaways for your career?**
  - Know when to leave a toxic situation. Don't kill yourself and delay your career by staying in a company that doesn't allow you to make the contribution you are capable of, and reward that contribution.
  - Don't always blame yourself for not getting the promotion---it may be because of dynamics completely outside yourself. Always look at yourself, but also look outside yourself.
  - Always explicitly tie your behavior to the bottom line. Don't assume others will see that link. Tell them.

#### **Epilogue: What happened to the protagonists.**

Sherry negotiated a generous severance package and left the company on December 31, 2003. In the spring 2004, she is assessing her options. After Laura conducted systematic research about the new firm and boss, she accepted the job in December, 2003. Michelle stood by her decision to not accept the Executive Director position. She remains on the senior administrator's committee which is beginning the 6-8 month search for the next Executive Director in the spring 2004.

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# **Dot.com Versus Dot.bomb: The Strategic Challenges of Starting an E-business**

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## **ABSTRACT**

WineRegister.com is an entrepreneurial venture which developed when its founders recognized an unmet customer need they shared – their frustration with the local availability of “estate” wines. Given conditions in the wine industry and the telecommunications industry, readers are challenged in Part A to develop a viable internet business concept to exploit an unmet customer need. Part B profiles the challenges of an entrepreneurial solution to that challenge – WineRegister.com. The case follows the strategic implementation of the partners’ plan through the start-up phase, and explores issues around maintaining strategic focus and respecting partner preferences while courting external capital – VCs, angels, partners, and buy-out opportunities.

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## **Intended Audience and Placement In Course Instruction**

This case is designed for entrepreneurship or strategy courses on the upper-graduate and MBA levels. The case can be positioned in the course in two ways – as an example of the strategic challenges involved in translating an unmet customer need into a viable business, or as example of the strategic challenges involved in starting an e-business venture in cyberspace. In any of these scenarios, the case would likely be presented in the middle to end of the course.

All information on WineRegister.com stems from two sources – the initial business plan (IGS, 2001), and from extensive interviews with the Chief Financial Officer of WineRegister.com, Dan Mitchell (all direct quotes are taken from an article on entrepreneurial exit strategies: Page & Mitchell, 2003).

## **PART A: DOT COM VERSUS DOT BOMB**

Dan Mitchell was in the mood for something different, something special, to accompany a gourmet meal. After reading a wine magazine, he found the wine he wanted – a special vintage with a unique, fruity bouquet from a small estate winery in the Pacific Northwest. There was



only one problem – he could not find it. His favorite wine merchant did not carry it, and he did not want to spend all night calling or driving around looking for it. His frustration spoiled his appetite, but sparked his entrepreneurial vision. “Surely,” he mused, “There must be some way to use the internet to meet the needs of frustrated wine consumers like me.” The seed idea behind WineRegister.com began to germinate.

### **To Wine or Whine?**

In 1999 the partners met in New York to discuss a new entrepreneurial venture – an internet wine service they would call “The Wine Register.” The partners sensed an unmet, unarticulated market need from personal experience and frustration – sometimes they had had heard of an interesting wine, but their local wine merchant did not carry it. They could special order the wine in some states, but the additional cost and the additional wait involved often dampened their appetite. Usually they experienced no trouble finding the well established, mass produced wines of major national and international wineries – those labels are fairly ubiquitous at virtually any local liquor stores. The challenge was finding the estate wines; the new or unusual vintages usually introduced by U.S. estate wineries or small foreign wineries. These estate and foreign vintages are relatively rare, because their production is limited due to the relatively small size of these wineries. Unless a customer’s local liquor store just happened to stock a particular estate wine of interest (and the odds were not good), convenience and accessibility become problematic.

The serious wine taster can opt for membership in a wine club, which will feature certain vintages of estate wineries each month. But once again, the offerings are limited, and members may be directed to the wines of estate wineries who have cut special deals with the club, rather than those who offer the most distinctive new wines. Given the limited selection of profiled

wines, club members may not find a wine to suit their tastes. They can also special order the wine if they live in one of the 23 states which allow direct shipment of wine to retail customers. If they happen to live in one of the other 27 states, or are not willing to wait days for shipping, they are out of luck. How can the partners meet this unmet customer need in all 50 states?

### **The Wine Industry**

This is a \$19.8 billion market place (Wine Institute, 2002), with 2038 wineries in the U.S., 6066 dedicated retail outlets, and 847 distributors. The potential of the market is much greater, since there are many more stores which are not dedicated, such as supermarkets which feature wines as one of many product lines. The wine market has shown a 32% increase in sales in the past 5 years and continues to grow at a 3% rate annually (IGS, 2001). In general, wines have increased in popularity, while hard liquor has declined in popularity.

<b>Year</b>	<b>Volume</b>	<b>Retail Sales of Wine</b>
1990	509 million gallons	\$11.7 billion
1991	466 million gallons	\$10.9 billion
1992	476 million gallons	\$11.4 billion
1993	449 million gallons	\$11.0 billion
1994	459 million gallons	\$11.5 billion
1995	464 million gallons	\$12.2 billion
1996	500 million gallons	\$14.3 billion
1997	520 million gallons	\$16.1 billion
1998	526 million gallons	\$17.0 billion
1999	551 million gallons	\$18.1 billion

In the U.S., seven major wineries control 72% of domestic wine production and 92% of the advertising dollars, which are typically spent on expensive national advertising campaigns during critical sales periods, such as around the holiday season (IGS, 2001). The remaining 2000 plus smaller “estate” wineries, as well as over 6000 smaller foreign wineries, struggle to build brand awareness and increase distribution (Wine Institute, 2002). Many of the estate wineries depend on wine tours and drive-by, rubber tire traffic to establish their name and develop what

are termed “farm gate” sales. Farm gates sales are geared toward the wine tour circuits, where tourists sample the wines and make limited purchases, but seldom return as repeat customers. Other marketing options for estate wineries are limited.

**Industry structure.** Smaller wineries also have to cope with the unique regulatory environment created by the 21<sup>st</sup> amendment of the U.S. constitution, which prohibits wine producers from directly selling to the wine merchants who retail the wine. By necessity, distributors are legally mandated intermediaries between wineries and wine merchants.

Distribution channels are pictured below:

<u>Manufacturers</u>		<u>Wholesalers</u>	<u>Retailers</u>
Foreign Wineries	Wine Brokers	Importers	Wine Merchants
Domestic Wineries		/ Distributors	
Estate Wineries			Wine Clubs

The only major channel for large volumes of wine runs straight through a limited number of large distributors/importers. Distributors create a huge bottleneck between the wineries and the wine merchants by focusing on mass produced wines, and largely ignoring the vintages of smaller wineries. Major distributors usually do not bother with relatively small volumes of new wines with unproven demand – they fear too much of this type of inventory will take up space, tie up capital, and gather dust. There is an informal refusal policy to handle more than two lines of competing wines at a time (Page & Mitchell, 2003). While distributors do stock a few estate wines, these efforts are mere afterthoughts to their bread and butter business – moving large volumes of mass produced wines from the major wineries. This was a proven strategy to maximize profit and avoid diminishing returns.

When distributors use wine brokers to secure certain vintages, the brokers offer a “by the bottle” service that is convenient but pricey. This premium pricing severely restricts consumer

demand. The only reliable distribution channel for estate wineries are wine clubs, which bypass distributors. However, not only do wine clubs move much smaller volumes of wine than distributors, they tend to restrict their offerings to vintages of sponsored estate wineries.

Increasing demand for estate wines has always been prohibitively expensive. Only the large, national wineries can afford national advertising campaigns, typically launched around the holiday season. Wineries who can not afford national advertising must rely on their distributors to create interest and sales for the wine label among the distributor's wine merchants. In order for the distributor to agree to carry their wines, the winery must agree to financially participate in wine tasting programs and competitions, and support any merchandising programs the distributor supplies to the wine merchants. This strategy can be criticized since such efforts are not affordable, measurable, nor appropriately targeted towards their customer base.

Given the concentration of large producers, local wine merchants find it difficult to expand their business beyond their immediate clientele, who tend to make habit purchases from the major labels at a conveniently located store. In the US in 2002, over 30 thousand wine merchants stock the major labels using relatively standard, undifferentiated pricing (IGS, 2001). These retail outlets tend to be small, and independently owned, due to legislative requirements imposed by individual states and the 21<sup>st</sup> amendment. Because of this regulatory environment, there are no national wine chain stores (the euphemistic "Wine Depot"). Wine merchants contacted by the partners indicated a reluctance to carry a variety of estate and foreign labels from minor wineries – there were too many horror stories where this kind of inventory gathered dust, because of a lack of customer awareness. Nor could these local stores afford the type of marketing campaigns necessary to publicize estate and foreign labels from estate wineries – the profit margins on such small volumes of wine simply did not justify the expense.

## **The Wine Industry in Cyberspace**

On the internet, there are three major types of wine related electronic businesses: wine merchants, wine clubs, and wine publications. Internet wine businesses involving the shipment of wine to consumers are constrained by variety of state legislation regulating or prohibiting the direct sale of wine to retail customers. The nature of these restrictions varies widely, depending upon the state. Direct shipments are permitted in only 23 states: Alaska, Arizona, California, Colorado, Connecticut, Florida, Iowa, Idaho, Illinois, Louisiana, Massachusetts, Michigan, Minnesota, Montana, North Carolina, Nebraska, New Hampshire, New Jersey, New Mexico, Nevada, New York, Ohio, Oklahoma, Virginia, Washington, and West Virginia. Even within those states, additional restrictions are sometimes imposed on out-of-state wine merchants. While there are a variety of ongoing legal challenges and legislative efforts trying to remove these restrictions, they are unlikely to quickly disappear (Wine Institute, 2002).

**Internet wine merchants.** Over 4400 website merchandisers offer direct order wines, but none are dominant players (Wine Institute, 2003). For a comprehensive on-line directory of some of the larger internet wine merchants, consult [www.vinetowine.com/wineonline.htm](http://www.vinetowine.com/wineonline.htm). While some are true e-businesses, many represent the internet distribution channel of a larger organization that also sells wine through traditional channels, such as distributors, restaurants, or “brick and mortar” stores. These websites tend to position themselves in two ways: through the variety and price of their offerings. The variety of offerings ranges from a broad selection of wines from across the globe, to a limited selection featuring only the labels of a particular wine producing region, to winery stores exclusively offering their own vintages. In terms of price, some websites emphasize the value or pricing of their offerings, while a minority offer premium vintages to wine connoisseurs, and charge accordingly.

**Internet wine clubs.** Another set of internet wine merchants are the cyber wine clubs, which offer selected vintages to their members. The wines selected have been evaluated as being distinctive by either wine experts of the club, or in published reviews of wine experts featured in wine magazines. Clubs range from truly on-line, internet operations to being on-line affiliates of on-ground wine merchants. Some even offer chatrooms for cyberspace discussion and appreciation of their wines (for example, see [www.wineloverspage.com](http://www.wineloverspage.com)).

Once again, the wine offerings in the various clubs range from a broad global selection, to the vintages of a particular wine producing region, to the vintages of a particular winery. For a comprehensive listing of wine clubs and associations, see the clubs and associations page of [www.webwine.com](http://www.webwine.com). The larger cyber clubs with global wine offerings include:

Wine Company Club	<a href="http://www.winecompany.com/wineclub.htm">www.winecompany.com/wineclub.htm</a>
The Wine Club	<a href="http://www.thewineclub.com">www.thewineclub.com</a>
Wine.com Club	<a href="http://www.wine.com">www.wine.com</a>
Wine Brokers Club	<a href="http://www.winebroker.com">www.winebroker.com</a>
Wine Masters Club	<a href="http://www.wine-master.com">www.wine-master.com</a>
Wine of the Month Club	<a href="http://www.winemonthclub.com">www.winemonthclub.com</a>

**Internet wine publications.** While all of the on-line wine publications feature information and articles, most also offer purchasing opportunities for wine, accessories, and travel, either directly, or through sponsored links.

Most wine producing regions have an industry association to convey the proud history and wine-making traditions of the locale. They also provide readers with travelogues and maps, and contact information for wineries and wine tour opportunities (for example, see New York's [www.nywine.com](http://www.nywine.com)).

Another class of internet wine publications is the on-line wine magazine, often affiliated with an on-ground wine publication. They provide industry news, profile distinctive or award winning wines, present recommendations and/or recipes using those wines, and generally do

their best to convey the “mystique” of wine consumption. They abound with on-line advertisements and sponsored links to purchase wine and wine accessories. (for example, see [wineontheweb.com](http://wineontheweb.com), [winespectator.com](http://winespectator.com), [wineenthusiast.com](http://wineenthusiast.com), and [wineadvocate.com](http://wineadvocate.com)).

**Internet Wine Location Search Engines.** Websites with on-line wine locators fall into two broad categories: winery cartographers (winery, regional association and travel guide websites) and the on-line sales engines.

The “winery cartographer” websites are sponsored by individual wineries and regional wine associations. Location information on the winery websites is usually limited to basic directions and contact information. The association websites use locator search engines to direct interested wine consumers to local wineries, complete with maps and contact information (for example, see New York’s [www.nywine.com/winelocator/index.asp](http://www.nywine.com/winelocator/index.asp)). A few locators are specifically geared towards the tourist class, providing detailed information and travelogues on wineries they regard as noteworthy, picturesque, or otherwise interesting enough to justify a visit, either individually or as part of a wine tour. These sites (such as [www.all-Americanwines.com](http://www.all-Americanwines.com) and [www.wines-across-america.com](http://www.wines-across-america.com)) usually link to regional association and wine tour operator websites.

Other locators are designed to be on-line sales engines, brokering sales by using locators to direct purchasers to sponsored sales affiliates. For example, both [www.wineaccess.com](http://www.wineaccess.com) and [www.wineweb.com](http://www.wineweb.com) offer locator services that link specific vintages with specific merchants. WineWeb.com allows consumers to research wine from thousands of wineries by region, type of wine, or winery. These locator services tend to prioritize on-line sales opportunities over providing the location of local wine merchants. Consequently the sites are dedicated to linking customers interested in a particular vintage with preferred on-line merchants.

## **Dot.bomb Paranoia**

The partners want to launch their new service in 2001. Unfortunately, with the telecom industry in full meltdown mode, this was hardly ideal timing to raise external funding. In order to be taken seriously in the capital markets, you will have to prove your new venture will (a) target significant unmet customer needs in your chosen industry, (b) have a promising distinctive competence that sets it apart from Internet competitors, and offers sustainable competitive advantage, and (c) can become financially solvent in short order (Porter, 2001). The partners have asked you to help them design an internet service that will fill the bill, and they do not have the money to fund a complete national rollout by themselves.

### **PART B: WINEREGISTER.COM**

(All of the information in this section, except where otherwise noted, is summarized from the business plan of WineRegister.com (IGS, 2001)). The challenge was to avoid becoming yet another of the thousands of internet wine merchants, particularly given the legal complications of trying to ship wine directly to consumers in most states. Becoming yet another wine club was not the answer, either, for similar reasons. The partners felt that wine is not a product that people buy on a subscription basis, it fills a specific need at a specific time and in most cases is matched in comparison with other products or occasions. The time to purchase is relatively short -- no longer than 72 hours -- making availability a critical factor. On ground, brick and mortar merchants also had a critical profitability advantage of impulse buying as customers wandered through their stores and admired their displays. Mitchell felt on line merchants would never be able to match such impulse buying opportunities -- from his perspective, you go to a website looking for a wine, not to wander through it (Page & Mitchell, 2003).

Given the ongoing profitability problems of many internet providers, the partners were



not convinced that direct net sales were a viable business model. In essence, e-business was not expanding this market, just offering a different ordering option that had some undesirable drawbacks and unacceptable limitations for many consumers. The WineRegister.com concept had to drive business to local brick and mortar stores and expand the market. If they focused on advertising instead of sales, and could find a way to link consumers with the wines they wanted, WineRegister.com could tap into some of the advertising dollars spent on this 19.8 billion dollar US retail industry (Wine Institute, 2002). Since the main drawback to stocking new, estate and foreign vintages is slow demand and inventory costs, WineRegister.com focused on developing a marketing approach which will generate a consistently higher demand for featured wines, allowing distributors and retailers to plan for moving a higher volume of those vintages.

### **Internet advertising**

Why not create service where customers could log on, search for their favorite wine, and receive directions to the nearest wine merchant who carries it in their local, geographic area?

The idea for Wine Register.com was born – an internet marketing engine for the lovers of estate wines. This was the corporate mission statement:

IGS, Inc's mission is to become a unique internet based wine resource for the consumer and will be driven by its customers. The company is dedicated to building long-term relationships with its customers by providing excellent service and demonstrable value. The WineRegister is a place for local wine stores to expand their market penetration and significantly increase their revenue and for Wineries to support their distribution chain through innovative and progressive marketing. We view ourselves as partners with the wineries, distributors and local wine stores, who supply the products and the consumers who are motivated to buy at the local WineRegister wine store, and with our employees who form the backbone of our business. Our goals are to expand quickly and to become the leader in the field. (IGS, 2001, p. 5)

The goal of this service was to link customers with local wine merchants within a 5 mile radius of any location they provide, as well as offering information they need to select wines that would appeal to their palate, rather than simply evaluating price, packaging appeal and brand

recognition. This entrepreneurial opportunity stemmed from the fact that currently no mechanism existed in print media, other websites, point of purchase displays, or other media, directing consumers to the closest point of purchase. Best of all, the lack of direct sales sidestepped all the legal restrictions that plague most internet wine merchants. The Wine Register.com had this vision for potential estate wine customers:

Robert hears about an exciting new wine. He logs on to Wineregister.com, types in the name of the wine at the prompt, and learns more about this vintage, including the history of the wine, reviews of the wine, cooking and presentation tips. If he decides it suits his tastes, the database identifies the nearest wine store in his area which carries the wine, by linking zipcode with a five mile radius around the submitted starting location. The website also offers Robert referrals to related products, such as proprietary cookbooks and magazines. The wine merchant now has a new on-ground customer interested in a wine he did not previously know was available in his area. And the winery has better exposure through the website, and word of mouth. (Page & Mitchell, 2003, p. 63)

The wine merchants gained new clientele, while reducing the overall advertising and marketing expenses of those stores, so profitability increases. Wine inventories and other industry information linked to participating merchants were accessible to customers through a relational database on the website. At the same time, WineRegister.com tracked customer interest in estate wines, as well as providing on-line and on-ground marketing materials to move profiled vintages (IGS, 2001). This was Mitchell's vision of the marketing plan, and the benefits it offered in increasing sales volumes of estate wines:

Kendall Jackson (an estate winery) signs up to move a red and white on the Wine Register, so they can increase production to cover the increased demand which the website will generate. Wine merchants receive display material, mailers and coupons (and the coupons build the website by requiring e-mail addresses to be redeemed). Based on past data, the merchants can count on moving an additional 5 cases of each. Further, based on past data, the distributors can place larger orders knowing they will be able to move greater volumes of normally slow moving wine. (Page & Mitchell, 2003, p. 64)

Wineregister.com was based on the premise that the web is a powerful marketing tool since most wine consumers come from demographic groups associated with computer skills and

internet access – over 85% of wine sales go to consumers aged 21 to 59 who made over 50,000 dollars a year. These were the more discriminating customers interested in medium priced (14 to 25 dollars per bottle) and high-end (above 25 dollars per bottle) wines. These segments of the market were judged as having the greatest growth potential in the future, while the lower end segments were predicted to remain flat, having already been saturated (Wine Spectator, 2001).

### **Related Products**

WineRegister.com planned on expanding from advertising to educational features within two years. These products and services would be available on a subscription basis.

**Incentive Programs.** Many wine stores had membership programs that could provide the basis for discounts on case purchases, allowing subscribers to benefit from additional discounts on case lots, and access to wine tours and promotional wine cruises.

**Cookbooks.** After establishing 150 wine stores within the marketing program WineRegister.com planned to be in a position to publish a series of cookbooks. These cookbooks would be designed to combine wine and food, and are proven money-makers. The participating wine stores became a quick distribution network, with very little associated development costs.

Further, the cookbook series could be expanded into a "how to" web site. This on-line service would offer a subscriber based series of web based step-by-step tutorials available through a subscription. Purchasers of the cookbooks would have access to the tutorials free for the first 30 days and then be invited to subscribe for a nominal annual fee.

**Magazines.** For three years IGS researched the specialty publishing market for Brown Printing and Gruner+Jahr, wholly owned subsidiaries of Bertelsmann. The specific target market was the retail food industry. That research indicated that major retail groups such as Safeway and Krogers would move into the publishing of magazines to provide their customers with a

value added program supported by marketing funds available from the manufacturers and distributors of food products. The WineRegister.com mass market entry into this field will be named, “Enjoy” and its title had been registered. Another magazine would target wine connoisseurs with more rarified tastes, and the kind of disposable income to routinely spend hundreds of dollars on a memorable vintage for a special occasion, or for their private collection. “Vinter’s Reserve” would be published to address this high end market segment.

### **Pricing Strategy**

WineRegister.com offered two tiers of service – basic listing, and pull advertising. The service was free for consumers, but not for wine merchants, distributors and wineries. A basic listing on the website, so customers seeking a particular vintage your store happened to carry were sent your way, cost \$1,500 per quarter. Merchants wishing to increase customer demand for selected estate wines could sign up for additional advertising blocks. Each block costs \$900, and featured 4 estate wines. Whenever a wine merchant purchased a block, the distributor handling those wines was also charged \$900, and the winery producing each of the profiled wines was charged \$900 per wine. Consequently each advertising block yielded \$4500, which basically covered the cost of all of the advertising materials provided to the distributors and wine merchants, including mailers, coupons, window displays and decals, point-of-purchase displays, shelf-talkers, restaurant promotion cards, register tape imprinting, and other services.

Further, in the supermarket business all food purveyors must provide co-op dollars for advertising and now also provide market development dollars. Using those dollars on Wine Register made it possible for the smaller stores to get some of the benefits enjoyed by the giants (Safeway, Albertsons, etc.) This would be the first program allowing small organizations to create sales for specific locations underwritten by co-op dollars.

Distributions were willing to pay for this program given the revenue potential it offered. While distributors were attracted by the high profit margins offered by estate wines, their primary motivation was one of avoidance – they dreaded the cost and inconvenience of large inventories of slow movers. Distributors who participated would receive detailed information on who was shopping where, what wines were moving, frequency of purchases, and price ranges customers were interested in. They would be able to stock certain traditionally slow moving brands knowing that demand would increase because of their participation in Wine Register.com.

While the pricing for most of the related products and services had yet to be negotiated, they could be estimated for cookbooks. Cookbooks of the proposed type retail for \$14.95, cost six to eight dollars to produce and would provide IGS with a net of two dollars per book. The wine store, on the sale of 250 cookbooks over the period of two months, would earn \$1250.00 dollars with no risk as IGS would carry the inventory costs through the publisher. The cookbooks would be supported through an informational page on the WineRegister.com web site and on the postcards mailed in the marketing program.

### **Ownership**

The partners decided to launch WineRegister.com as a privately held S corporation, jointly owned by the partners with no other stockholders. The partners of WineRegister.com were seasoned professionals in the business community, who had previous entrepreneurial experience working together on other ventures. They felt they could adequately handle the challenges of managing this new venture. Their previous successes allowed them to provide about one million dollars in personal funds to get the venture off the ground while Mitchell looked for additional financing. Their qualifications are reprinted below from the business plan:

**Jack Ellison.** Recognized as an authority in the development of markets through the application of new technologies within the graphic arts industry, Jack Ellison has been

widely published and has lectured throughout North America. For the past ten years he has assisted printing companies, the largest of which is owned by Bertelsmann with a sales volume of \$350,000,000.00, in the development of new markets. Working as a mentor to the owners and senior management he has been proven effective in creating increased profitability and a higher ROI. ... As a component of one of the printing companies under his management he established a consulting group dedicated to assisting the hospitality industry. This group was responsible for the food marketing of many of North America's leading hotel and restaurant chains. As a result of the work this group did Jack developed a working knowledge of food production and distribution. He also became the owner of a very successful free standing restaurant and a partner in a chain of fourteen restaurants.

**Tim Ellison.** During the past twenty-five years Tim Ellison has worked at every level of the hospitality industry. A certified Chef-de-Cuisine, a graduate from BCIT with a diploma in Hospitality Management, a certified educational instructor with the practical knowledge that can only be attained through a concentrated determination to work through all positions in the restaurant and hotel industry. Tim sits on the board of major educational institutions affiliated with the Food and Beverage Industry in Canada. He lectures regularly and is in great demand for the development and presentation of training programs for associations and corporations. He has a very good understanding of trends that affect the hospitality industry through his extensive travel in North America. He is recognized as an authority on the development of wines through his membership in the Society of Wine Educators and the American Wine Appreciation Society. He was the chef/owner of a successful restaurant for five years. ...

**Dan J. Mitchell.** During the past thirty-five years Dan Mitchell has held a variety of management positions in the technology, financial and graphic arts industries. He has been on the leading edge of technology in the graphic arts industry and worked as a consultant for Indigo America in the installation and introduction of their electronic press equipment in North America, he has written several articles and lectured to many groups on creative marketing and disruptive technology. Mr. Mitchell is currently involved with ACE-Net.org, an internet based listing service for start-up companies and angel investors and was awarded the SBA's Vision 2000 award for his efforts in expanding capital to small businesses. Mr. Mitchell holds an MBA from the University of Michigan and has held faculty positions at several North American Universities. He has been involved with IGS as a founding partner and has worked with Mr. Ellison on several projects over the past 10 years (IGS 2001, pp. 16-17).

## **Corporate Structure**

WineRegister.com was a network corporation with little overhead. The firm was incorporated in both Vancouver, Canada, and Seattle, Washington. All work processes involving collaboration between the partners were internet-based. Whenever possible, the partners

contracted out managerial tasks including website development, network tasks, server maintenance and redundancy, accounting, graphics development, and similar technical tasks. They preferred to use Canadian subcontractors, who tended to be less expensive due to low labor costs and a weak Canadian currency. With the partners working independently, and separated by hundreds of miles, effective communication became more complicated and impersonal. However, the partners felt that the advantages of minimal overhead outweighed these drawbacks.

Subcontracting the website development was of particular concern. Given that the website will not feature proprietary technology, no patent or copyright protections will be possible concerning the concept. An opportunistic website developer could take advantage of the situation. Consequently, the website was developed in three parts by three separate software firms, with careful specifications to ensure compatibility. Each firm saw only part of the puzzle, until the website was up and running.

### **Start-up Phase**

This venture was not going to be cheap, and some strategic options required external funding. Ironically, the actual website development would be relatively inexpensive – the entire website package would be ready to go to market for under 75K. The major costs would be incurred during the rollout. They consisted of :

- 400K for development of point of purchase materials (shelf talkers, banners, displays)
- 250K for direct mail expenses (mailing lists, postage, printing costs) with 50K needed for the first territory, (the Northwest).
- 40K for one full-time person to manage mailing lists and the website.
- 250K per year per territory to support a regional manager with support staff.
- 30K per year for corporate sales expenses (travel, client entertainment, etc.)

The partners were willing to invest over 1 million of their personal funds to get the business started. In order to pursue aggressive growth strategies, the CFO, searched for an additional 500K from outside investors. The availability of the additional cash was critical to complete the

national rollout within a year. Without the external funding, the partners estimated that it would take up to 3 or 4 years to complete the national rollout, assuming that WineRegister.com met or exceeded its projected sales and revenue targets.

WineRegister focused on a regional market development strategy by dividing the U.S. into 4 geographic territories or quadrants: North West, South West, North East and South East. Each quadrant would be led by an experienced regional manager. The initial plan called for introduction in the North West first with an intensive product launch and mailing to the identified zip codes surrounding participating retail outlets. Within 30 days the second launch should occur in the North East followed by the South West and finally the South East, all within 90 days of the initial service introduction, if the funds are available. This will eliminate the possibility of copying and other start-ups gaining market share. This will require the presence of the territory manager on site to oversee the rollout in each of the territories. IGS focused efforts on consumers located within 5 miles of the retail outlet, initially on a blanket approach, however once data is accumulated, targeted approaches will be used to direct specific products to definable segments.

The rollouts in the Northwest, Southwest and Southeast went virtually without a hitch. Mitchell attributes this success to the quality of the regional managers (Page & Mitchell, 2003). They paid top dollar for top people (salaries in the 200K range). These peak performers were identified by industry contacts as talent who had at least 15 years experience in the wine distribution business, and who had excellent knowledge of and relationships in local markets.

## **Financing**

Securing funding proved to be more of a headache. While the partners wanted the funds, they were financially solvent, so they were not desperate. They had a well-defined strategic plan, and



wanted the external investors to be relatively silent partners, not controlling or meddlesome partners. Rather than lose control of their venture, they would rather either continue what they were doing with internal funding, or turn the business over to someone else and pursue a similar venture in an unrelated parallel market. WineResigter.com considered the following options:

**Angel Investors.** Angels are high net worth individuals who have over a million dollars to invest. The angel the partners approached for 500K was slow and cautious, taking months to negotiate a potential deal. He was looking for 30% of the equity, and 25% annual returns, with a 3 year buyout option. The partners also considered multiple angels (a consortium of up to 10) who were willing to invest 50K each. Four agreed to invest contingent upon a lead investor who would invest 150 to 200K, but securing a suitable lead investor proved to be very difficult.

**Venture Capital.** VCs are professionally managed investment companies; typically the high risk arms of banking institutions. Two groups were interested. Group A wanted 60% equity and control of the board for 500K. The partners did not take this offer seriously – this VC group was too greedy. Group B offered one round of financing, raising 500K, for 30% equity, 2 seats on the board of directors, and installing their own Chief Financial Officer (CFO). The partners counteroffered 25% equity, 2 seats on the board, without a VC CFO. The VC group came back with an offer of 28% equity, 1 seat on the board, but insisted on their own CFO, and the partners refused. The VC group did make one last attempt to win them over. They offered 2 rounds of financing, raising a total of 1 million dollars. In return, they need 35% equity, 2 board seats and their own CFO.

**Partnership.** The obvious partners were either large distributors or a group of estate wineries who recognized the potential of the website to expand their market share. Both groups could access the major league resources needed to drive a national rollout, particularly the

distributors. The partners offered 10 owners of estate wineries a total of 20% equity and 1 board of directors member in return for 50K from each investor. Given that this sort of arrangement had never been negotiated before, structuring the final deal would be a bit of an adventure. Negotiations were proceeding relatively smoothly, notwithstanding.

**Take the Money and Run.** Within a year, Gallo, one of the largest wineries in the world, got wind of Wine Register, and offered to buy the business. After protracted negotiations, Gall offered to buy the business for 8 million dollars. While the structure of the deal varied from offer to counteroffer, Gallo wanted to structure the payment so the largest percentage (approximately 65%) was in Gallo stock, the least (approximately 5%) was in cash, the hefty remainder (approximately 30%) was in future royalty payments. They refused to include any stipulation in the contract concerning a minimum value of those future royalty payments. The partners felt the stock portion of the deal was reasonable, but needed much more in cash and much less in royalties. Their lawyers suggested accepting a deal where the majority of the value was in Gallo stock (50 to 60%), some rested in future revenue payments (20 to 30%), and the remainder would be in cash (10 to 20%). The partners would sign a comprehensive non-compete, non-disclosure agreement, which would prohibit them from using this internet concept in any business for 5 years. They also would agree to provide personal services to ensure the smooth transition of the business over to Gallo for six months following the sale. The cash payment would be staggered so that some money did not transfer over until the end of the six month transition period.

Given the strategic goals of the firm, and the preferences of the partners, which option is most promising – stay the course, trade equity for external capital, or sell it off?

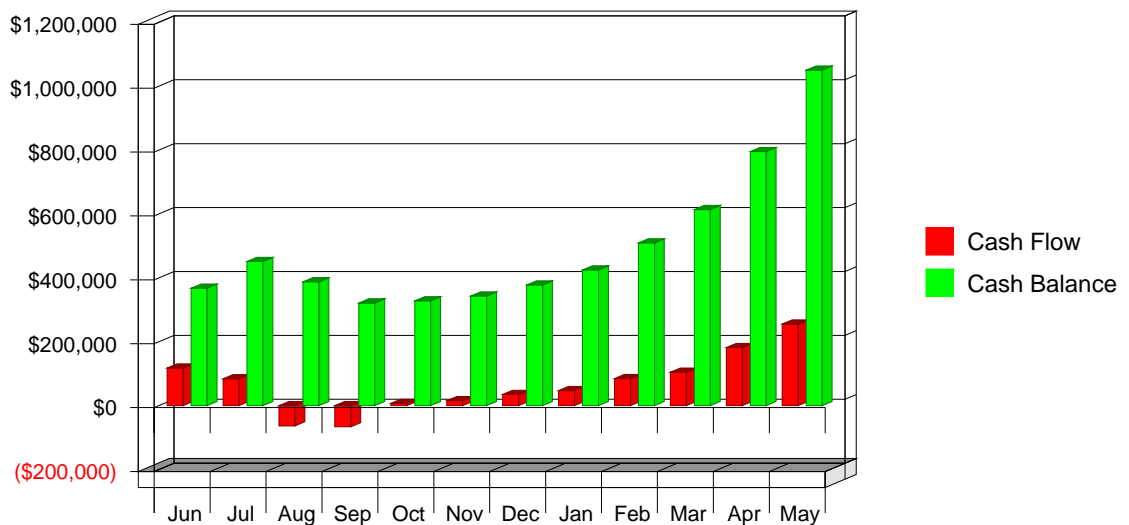
## Projected Profit and Loss

<b>Profit and Loss (Income Statement)</b>	<b>FY2002</b>	<b>FY2003</b>	<b>FY2004</b>
Sales	\$2,087,500	\$5,505,000	\$13,492,000
Direct Cost of Sales	\$58,500	\$115,000	\$398,000
Fulfillment Payroll	\$0	\$0	\$0
Other	\$224,550	\$0	\$0
	-----	-----	-----
Total Cost of Sales	\$283,050	\$115,000	\$398,000
Gross Margin	\$1,804,450	\$5,390,000	\$13,094,000
Gross Margin %	86.44%	97.91%	97.05%
 <b>Operating Expenses:</b>			
 <b>Sales and Marketing Expenses</b>			
Sales and Marketing Payroll	\$459,000	\$620,000	\$710,000
Advertising/Promotion	\$77,750	\$100,000	\$120,000
Travel	\$26,000	\$30,000	\$40,000
	-----	-----	-----
Total Sales and Marketing Expenses	\$562,750	\$750,000	\$870,000
Sales and Marketing %	26.96%	13.62%	6.45%
 <b>General and Administrative Expenses</b>			
General and Administrative Payroll	\$178,000	\$290,000	\$470,000
Payroll Burden	\$159,250	\$227,500	\$295,000
Depreciation	\$0	\$0	\$0
Leased Equipment	\$14,000	\$20,000	\$35,000
Utilities	\$19,100	\$25,000	\$30,000
Insurance	\$15,000	\$18,000	\$24,000
Rent	\$37,200	\$40,000	\$50,000
	-----	-----	-----
Total General and Administrative Expenses	\$422,550	\$620,500	\$904,000
General and Administrative %	20.24%	11.27%	6.70%
Profit Before Interest and Taxes	\$658,050	\$3,829,500	\$11,095,000
Interest Expense Short-term	\$0	\$0	\$0
Interest Expense Long-term	\$0	\$0	\$0
Taxes Incurred	\$164,513	\$957,375	\$2,773,750
Extraordinary Items	\$0	\$25,000	\$75,000
Net Profit	\$497,288	\$2,897,125	\$8,396,250
Net Profit/Sales	23.64%	52.63%	62.23%

## Projected Cash Flow

<b>Pro-Forma Cash Flow</b>	<b>FY2002</b>	<b>FY2003</b>	<b>FY2004</b>
Net Profit	\$497,288	\$2,897,125	\$8,396,250
<b>Plus:</b>			
Depreciation	\$0	\$0	\$0
Change in Accounts Payable	\$84,111	\$105,430	\$332,974
Current Borrowing (repayment)	\$0	\$0	\$0
Increase (decrease) Other Liabilities	\$0	\$0	\$0
Long-term Borrowing (repayment)	\$0	\$0	\$0
Capital Input	<u>\$300,000</u>	<u>\$0</u>	<u>\$0</u>
Subtotal	\$881,398	\$3,002,555	\$8,729,224
<b>Less:</b>			
Change in Accounts Receivable	\$81,500	\$133,426	\$311,828
Change in Other Short-term Assets	\$0	\$0	\$0
Capital Expenditure	\$0	\$0	\$0
Dividends	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>
Subtotal	\$81,500	\$133,426	\$311,828
Net Cash Flow	\$799,898	\$2,869,129	\$8,417,397
Cash Balance	\$1,049,898	\$3,919,027	\$12,336,424

## Cash



## Projected Balance Sheet

<b>Pro-forma Balance Sheet</b>	<b>FY2002</b>	<b>FY2003</b>	<b>FY2004</b>
<b>Assets</b>			
<b>Short-term Assets</b>			
Cash	\$1,049,898	\$3,919,027	\$12,336,424
Accounts Receivable	\$81,500	\$214,926	\$526,754
Other Short-term Assets	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>
Total Short-term Assets	\$1,131,398	\$4,133,953	\$12,863,177
<b>Long-term Assets</b>			
Capital Assets	\$0	\$0	\$0
Accumulated Depreciation	\$0	\$0	\$0
Total Long-term Assets	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>
Total Assets	\$1,131,398	\$4,133,953	\$12,863,177
<b>Liabilities and Capital</b>			
	<b>FY2002</b>	<b>FY2003</b>	<b>FY2004</b>
Accounts Payable	\$114,111	\$219,541	\$552,515
Short-term Notes	\$0	\$0	\$0
Other Short-term	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>
Liabilities			
Subtotal Short-term	\$114,111	\$219,541	\$552,515
Liabilities			
Long-term Liabilities	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>
Total Liabilities	\$114,111	\$219,541	\$552,515
Paid in Capital	\$600,000	\$600,000	\$600,000
Retained Earnings		\$417,288	\$3,314,413
Earnings	\$493,538	\$2,897,125	\$8,396,250
Total Capital	\$1,017,288	\$3,914,413	\$12,310,663
Total Liabilities and	\$1,131,398	\$4,133,953	\$12,863,177
Capital			
Net Worth	\$1,017,288	\$3,914,413	\$12,310,663

## Business Ratios

<b>Ratio Analysis</b>	<b>FY2002</b>	<b>FY2003</b>	<b>FY2004</b>	<b>RMA</b>
<b>Profitability Ratios:</b>				
Gross Margin	86.44%	97.91%	97.05%	0
Net Profit Margin	23.64%	52.63%	62.23%	0
Return on Assets	43.62%	70.08%	65.27%	0
Return on Equity	48.52%	74.01%	68.20%	0
<b>Activity Ratios</b>				
AR Turnover	25.61	25.61	25.61	0
Collection Days	7	10	10	0
Inventory Turnover	0.00	0.00	0.00	0
Accts Payable Turnover	6.29	6.29	6.29	0
Total Asset Turnover	1.85	1.33	1.05	0
<b>Debt Ratios</b>				
Debt to Net Worth	0.11	0.06	0.04	0
Short-term Liab. to Liab.	1.00	1.00	1.00	0
<b>Liquidity Ratios</b>				
Current Ratio	9.91	18.83	23.28	0
Quick Ratio	9.91	18.83	23.28	0
Net Working Capital	\$1,017,288	\$3,914,413	\$12,310,663	0
Interest Coverage	0.00	0.00	0.00	0
<b>Additional Ratios</b>				
Assets to Sales	0.54	0.75	0.95	0
Debt/Assets	10%	5%	4%	0
Current Debt/Total Assets	10%	5%	4%	0
Acid Test	9.20	17.85	22.33	0
Asset Turnover	1.85	1.33	1.05	0
Sales/Net Worth	2.05	1.41	1.10	0
Dividend Payout	\$0	\$0	\$0	\$0

## **Abbreviated Teaching Notes**

### **Overview of the Case**

This case profiles the challenges of developing a viable strategy to take advantage of an unmet customer need, and then successfully implementing that strategy. Given conditions in the wine industry and the telecommunications industry, readers are challenged in Part A to develop a viable internet business concept to exploit an undeniable opportunity – the fact that no current advertising medium exists to link wine connoisseurs with local retail wine merchants carrying the exotic vintages they crave. Part B profiles the challenges of developing a viable solution to that challenge – WineRegister.com.

### **Intended Audience and Placement In Course Instruction**

This case is designed for entrepreneurship or strategy courses on the upper-graduate and MBA levels. The case can be positioned in the course in two ways – as an example of the strategic challenges involved in translating an unmet customer need into a viable business, or as example of the strategic challenges involved in starting an e-business venture in cyberspace. In any of these scenarios, the case would likely be presented in the middle to end of the course.

### **Learning Objectives and Teaching Strategies**

On the most basic level, the first part of this case requires readers to analyze the industry structure of both the wine industry and its internet channels of sales and distribution. The case is designed for application of Porter's (1985) five forces model, and highlights the impact the general environment on business strategy – most importantly, political and legislative constraints (Longnecker, Moore & Petty, 2003). In the wine industry, restrictions created by the 21<sup>st</sup> amendment, coupled with a wide variety of state legislation, severely constrain the ability of internet firms to ship wines to interested consumers in most states. Further, the low barriers to

entry creates intense rivalry among cyberspace wine merchants, fragmenting market share. Differentiating a new venture in this kind of marketplace seems to be a nightmare, unless the reader changes the level of analysis from wine merchandising to wine advertising. Once the problem is redefined from how to sell estate wines to how to link interested customers with the local wine stores which carry specific vintages of estate wines, a novel opportunity presents itself. The WineRegister becomes a marketing engine, increasing the demand for estate wines at every stage in the distribution channel through “pull” strategies with the wine consumer. As an advertiser, it neatly sidesteps the legislative minefields involved in the sale of the wines.

The second part of the case explores the dilemma of retaining control of a start-up organization while trading equity for external funding. Given the unfortunate timing of the WineRegister, the CFO was trying to gain internet investors during the dog days of the telecommunications industry meltdown in 2001. Every alternative has its own set of strengths and weaknesses, demanding a comprehensive SWOT analysis of the new venture and its market. While relying on internal funding alone preserves equity, it slows the national rollout, creating opportunities for imitation and the loss of first mover leadership. Bringing in external equity makes the national rollout seamless, but may result in the loss of partner control of their own organization. Finally, there is the option of a buyout from a major winery, who may simply want to kill off the website. There is no clear cut “right answer” to this dilemma.

### **Overview and Discussion Concerning Related Literature**

The first part of the case offers a classic example of the impact of environmental trends on business strategy (Longnecker, Moore & Petty, 2003). Porter’s (1985) industry structure theory helps analyze opportunities and threats. Porter (2001) specifically analyzed the industry structure of the internet, and his article can be used to spur discussion and debate.



WineRegister.com will simultaneously increase the power of buyers while decreasing the power of distributors in wine markets featuring intense rivalries.

Resource-based theory gives perspective on the strengths and weaknesses of the firm, particularly the weaknesses. Readers can reference Barney's (1991) classic article on the strategic implications of resources, or read summaries included in most entrepreneurship texts (such as Dollinger, 1999; Longnecker, Moore & Petty, 2003). Both the strategy and internet technology used to develop this web service are highly imitable, since there is nothing proprietary about the technologies or services involved. This makes a fast national rollout a higher priority, to prevent a well-funded competitor from launching a national version before WineRegister.com gets there. Further, the partners lack experience in the wine industry, which can be regarded as a critical resource bundle.

Porter's (1985) generic strategy theory identifies WineRegister.com as a differentiator. WineRegister.com is offering a unique advertising medium – an on-line geographic wine locator service. Using differentiation strategies to remain competitive in rapidly changing environments has been extensively analyzed in the strategic management literature (Brown, 1998; Mockler, 2001). Given the rapidly changing and volatile nature of e-business, D'Aveni's (1995) classic "Hyper-competitive Rivalries" highlight the advantages that speed brings, and the risks that Gallo is engaging in a competitive freeze tactic to slow WineRegister.com down.

The obvious solution to the lack of resources and expertise is to make a deal with a venture capital firm to provide both. For a comprehensive treatment of venture capitalists, including a historical treatment on their philosophies and strategies, Gompers and Lerner (1999) analyze each phase of what they call the "venture capital cycle." For a consultant's handbook on venture capital outline decision criteria see Conneighton (2002).

This case offers a chance to explore the world of angel investing as well. Van Osnabrugge and Robinson (2000) provide a historical review of angel investing and a section giving practical advice to budding entrepreneurs on how to attract angel dollars. Others focus on practical advice for small deals and their investors (Benjamin & Margulis, 2001).

For in depth coverage of exit strategies in all their varieties are available, a variety of offerings cover a broad spectrum of firm sizes (King, 2002), and smaller businesses in particular (Engel, 1999; Hawley, 2002).

### **Suggested Case Questions**

#### **Questions on General Environmental Trends**

There are three major environmental trends affecting the wine industry. First, and most importantly, are the wide variety of legislative restrictions placed on the distribution and sale of wine. Second, technologic advances affect the wine industry, as wineries, wine merchants, wine clubs and associations, and wine publications have embraced new telecommunications advances, and have expanded from on-ground to offer an on-line distribution channel as well. Finally, socio-cultural shifts are affecting the wine industry. Due an increased awareness of alcoholism and related social ills, the popularity and sales of hard liquors continues to decline, while wine sales have continued to increase.

#### **Questions on Industry Structure**

The industry forces model helps explain the extreme fragmentation among internet wine merchants, and the intense rivalries in the wine industry.

Buyers have no power because they have limited information and access. Suppliers are powerful if they are distributors, acting as a bottleneck in distribution channels, because they are not interested in bothering with new wines with unproven demand, or with the small quantities

estate wineries produce. On the other hand, the ultimate suppliers are the wineries, and other than the major wineries, the smaller estate and foreign wineries are relatively powerless. They do not mass produce wines, and have no effective way of marketing their product. Many rely on farm gate sales and wine tour business to provide the bulk of their sales.

What distinguishes the wine industry is relatively low barriers to entry. Almost anyone can start a winery, and it is even easier to launch a winery website.

### **Questions on Strategic Implementation**

Part B chronicles the startup days of WineRegister.com, and the challenges of growing the business. In this case, some strategic options require external financing, and every major channel open to entrepreneurs is explored: VCs, angels, partners, alliances, and personal funds of founders, friends and family.

**Go It Alone.** The problems associated with strategies which could be implemented solely through internal funds and corporate revenues stem from the growth constraints imposed. Without additional funds, the roll-out would have to be long-term, with regional sequencing requiring years instead of months. Given the imitability risks, and the highly competitive nature of the industry, both Porter and Barney would argue that this option seems fraught with peril. This was the option currently being pursued.

**Venture Capital.** Strategic implementation could be accelerated in the short term with an infusion of VC funds, but the partners feared that in the long term, the strategies themselves would be compromised. The partners feared they would lose control of the company, and then the VCs would run it into the ground. The partners were growing the company by building a reputation for high quality and close customer service at each step of the distribution chain. The VCs would grow the company for short-term revenue return by mass marketing without building

relationships. This quest to generate revenue runs the definite risk of building beyond capacity. VCs would simply lack the patience.

**Angels and Partners.** Other funding sources offered definite advantages over VCs, in that carefully negotiated arrangements with angels or partners would preserve more control over the strategic direction of the company, and its finances. Unfortunately, if the partners decided to pursue external funding, these options would require too much time and negotiation. Angels are not used to this level of financial investment and risk, and partnership arrangements such as this were relatively novel in the Wine industry.

**Sell out to the major winery.** While a monetary payoff is very desirable, the partners were worried that the future royalty percentage of the deal might prove worthless. From one perspective, the major wineries may see this service as a threat to their market share, and will shut the website down. The concept dies and the partners have no control, and the royalty provisions are never fulfilled.

### **Epilogue**

After Jack Ellison had a heart attack, the partners decided to exit, and sell the firm. They pursued negotiations with Gallo for over a year, hoping to minimize the portion of the deal which involved future royalties. While they eventually reached an acceptable 6 million dollar deal, a last minute demand by Gallo proved to be a dealbreaker -- the comprehensive non-disclosure, non-compete provision in November of 2002. The partners looked elsewhere, and found a much more friendly suitor in Mondavi, the second largest winery in the US. The sale was completed in January of 2003. Mondavi is currently "retooling" the website for a grand reopening in January of 2004.

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## **Lacteos del Pacifico**

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*Presented at the VIP session of the Case Association 2004 Meeting*

Keywords: Developing World Entrepreneurship, Contingency Planning, Crisis Management

### **ABSTRACT**

A batch of soured milk and cream is delivered. Leads to discussion of contingency planning: (1) What to do in a crisis, and (2) How to avoid crisis

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On a Thursday afternoon in August 2002, Mr. Braulio Enríquez received a call that would end the relative tranquility he thus far enjoyed with his new business. His partner (and brother-in-law), Rubén Muñoz, informed him that most of their clients had returned their products from the previous week. The products were damaged. Immediately, Braulio left his office at the Salguanica School of Agriculture (SSA) and went to the facilities of the company that he had founded single nine months before. En route to Pegañal, a provincial capital on Salguanica's Pacific coast, Braulio worried about the future about his company and about his own reputation. He also wondered about the causes of the problem and thought about what could be done to avoid losing clients.

### **THE ORIGINS OF THE BUSINESS**

From very young, Braulio aspired to own his own business. His first attempt had consisted of raising bees. His father lent him money to buy the panels. Part of his entrepreneurial motivation came from his family, who had been cheese producers in the northwest corner of the country.

In 1980, Braulio had the opportunity to study at SSA, specializing in dairy production and processing. He subsequently completed graduate studies in Scotland, and returned to teach at SSA, which provided him and his family with security, while he sought out an opportunity to develop a business.

Braulio found such an opportunity with his brother-in-law, Mr. Rubén Muñoz. Rubén sold crude (nonpasteurized) milk house-to-house. In 1998, the Salguanica congress passed a law prohibiting the sale of crude milk. This represented a real threat for the future of Rubén's business, and he asked Braulio's help to learn the pasteurization process.

Braulio knew that simply pasteurizing milk and selling it would not be a good business. He also knew that if Rubén only pasteurized milk or cheeses, he would fail to take advantage of more lucrative by-products. So Braulio proposed to Rubén to go into business together not only to sell pasteurized milk or "queso fresco"<sup>1</sup>, but also higher value-added products such as sour creams,

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<sup>1</sup> *Queso fresco* is fresh, unripened cheese, sometimes called "country cheese." Similar to cottage cheese or Ricotta, it does not undergo a maturing process. It is mild, usually unsalted, without much flavor, and is a traditional staple of the Pegeño diet.

ripened cheeses, and yogurt (see Appendix 1), which could be made by processing using fat skimmed from the crude milk.

Although this was an attractive partnership -- Muñoz had access to customers and raw material (and a need for change), while Enríquez had technical knowledge and the desire to start-up his own business -- it would take two years to initiate the first tests.

Towards the end of 2000 (and with the law still not yet being enforced), the future partners decided to prepare samples to test the *pegeño* market (estimated population about 265,000). The tests had been promising and the partners decided to make the investment in machinery and equipment.

In August 2001, they began construction of a 300 sq meter plant. The new company was constituted Lácteos del Pacífico, S.A. By November they had received the basic equipment to initiate operations: a pasteurizing machine, molds, tables, cold room, and a skimming machine from France (Total cost: US \$20,000). The plant was built on Rubén's property and was located behind his house in Pegañal.

### **THE SALGUANICA DAIRY SECTOR**

In 2001, dairy was the third most important agricultural product of Salguanica after coffee and bananas. Salguanica has the highest per capita dairy consumption in Central America: 169 liters of milk annually. 15% of food expenses go to dairy products.

Per capita dairy consumption had increased annually. Local consumption (net of exports and imports) had grown in an average of 4.8% annually from 1982 (Appendix 2), whereas the population grew to an annual rate of 2%. growth in internal production in was even greater -- Salguanica reached self-sufficiency in 1987, and soon became an exporter. The rate of growth in production had been sustained by three factors:

1. Internal market protected from subsidized imports, enforced through permit restrictions
2. Development of several major processing plants by national companies and cooperatives.
3. An increase in technological capabilities. As of 1987,

Salguanica dairy producers could be divided into three categories: Three major national producers; many smaller, regional mechanized producers (including Lácteos del Pacífico). Finally, there were thousands of family producers whose production was directly consumed or traded in informal commerce. Braulio thought that once the new laws were enforced, Lácteos del Pacífico could serve these business' customers in Pegañal.

Eighty percent of dairy products sold in Salguanica were sold in the country's 45,000 retail stores, the overwhelming majority of which are tiny neighborhood storefronts, often nothing more than a stall, although in the capital region, supermarkets serving the middle- and upper-

class were becoming more popular. The other 20% were distributed through bakeries, restaurants, and institutions. Breakdown by product type is detailed in Appendix 4.

## **DAIRY PRODUCTION PROCESS**

Dairy production employs three sets of technologies: técnicas lecheras (milk or milking), técnicas mantequeras (churning into butter or related products), and técnicas queseras (conversion to cheese). Lácteos del Pacífico used suppliers for the raw milk, and focused on dairy conversion processes: técnicas mantequeras and queseras

Lácteos employed three fulltime workers. Additionally, Rubén's wife (Braulio's sister) worked half time, watching and controlling production and inventory levels, about which she consulted with Braulio daily.

The firm's breakeven production quantity was 400 liters per day. initial production settled at 500 liters daily with a goal of 1,000 liters per day for the second year. 500 liters daily yielded scarcely any profits, and the partners did not feel secure enough to leave or cut back on their regular jobs: Braulio continued to teach, and Rubén continued selling raw milk door in door.

Nevertheless, the business was succeeding: by August 2002, the company was producing 1,200 liters daily (Appendix 6).

The line of products beyond the staples of milk and queso fresco was initially limited to three types of cheeses (semi-hard, smooth and dry) and sour cream. They were planning to produce yogurt for the coming year, and continuing with a strategy of commercializing products with the greatest added value and profit potential.

Yogurt, like sour cream, was a highly profitable product. Comparatively, milk and queso fresco yielded low margins. The critical factor for these products was volume. The large national companies sold milk and queso fresco cheap as a way to hook-in clients.

Braulio observed that business profits depended on the percentage of fat contained in milk. In 2000, the year in which Braulio and Rubén conducted their initial tests, processed milk reached a fat level of 3.5%. Salguanica laws required a minimum level of 2% fat for milk and 1.5% for cheese, which would allow them to skim off substantial fat for more profitable items.

At the time, a kilogram of cheese sold for US \$2.30 and a liter of sour cream for US \$1.53. A kilogram of cheese required approximately seven liters of milk, whereas a liter of sour cream required only one liter, although this relation could vary depending on the existing fat level in milk. Milk as raw material accounted for most of the production costs (Appendix 8 and 9).

## **MANAGEMENT OF QUALITY IN MILK PRODUCTION**

In the first nine months of operation, the partners tried to consolidate the business. A critical problem throughout that time had been employee supervision, due largely to the absence of the partners in the company during the day. In the first months the company suffered high employee



turnover: some employees were unable to perform the tasks; others left because they didn't like the work. The result had been a high variability in the indices of quality.

Milk is an ideal medium for microorganism development. Therefore, all handling must take place under strict hygienic conditions. Immediately after the milking, milk contains a small amount of germs. This amount increases quickly with the contact with the air, the milking utensils, or the hands of the milker. In order to avoid the deterioration of the raw material, preservation measures are necessary and products must be processed as soon as is possible.

Quality controls must be applied at the beginning of the production process, especially for the raw milk, and must be implemented at the microbiological level. It is also necessary to ensure the validity of the measurements and that the correct tests are performed (Appendix 10).

The partners had planned to acquire the necessary equipment and hire a laboratory assistant to exclusively perform quality control when the production level reached a thousand liters daily. But by August 2000, they still had not done so.

**THE MARKET**

Lácteos del Pacífico clients comprised three groups:

40%	Pulperías -- small neighborhood stores serving most of the population (all but those wealthy enough to buy in the capital region)
50%	Institutional clients -- schools, hospitals, asylums, the ports and the enterprise zones where large numbers of production employees worked.
10%	In-plant and Rubén's route clients

It was common market practice to extend eight days to credit and to accept returns of products that were not sold or went bad. Between November 2001 and Julio 2002, returns for Lácteos del Pacífico averaged three percent.

A single commissioned salesman had responsibility for sales and distribution, except for the clients along Rubén raw milk routes, to whom he directly sold and distributed products.

Initially, products were distributed once-a-week (on Thursday). Later, distribution routes were also run on Mondays and Tuesdays. Braulio estimated that 80% of the distribution costs were to service the pulperías, which represented only 40% of the sales.

Lácteos del Pacífico did not publicize its products and the only marketing efforts were an occasional attempt to try to sell a potential new client. Yogurt was to be their first product supported by a publicity campaign.

Pegeños generally preferred simple natural products; packaging was seen as a form of adulteration. Knowing this, the partners decided on simple packaging -- a plastic bag closed with a knot.

### **SELLING TO THE PULPERÍAS**

Lácteos del Pacífico opened for business in November, the first month of summer in Salguanica, and, historically, a time at which suppliers could not maintain sufficient volume to meet demand. Retail competitors, who did not produce their own product, had to travel to other regions to obtain products to resell in Pegañal.

Nevertheless, they had difficulties with initial sales. Established competitors serving pulperías had important advantages, most important the fidelity of the owners whom they had long serviced. Often there were strong bonds of friendship or even family.

Braulio and Rubén did not request any kind of exclusivity or special considerations in these stores, only the opportunity to have their products available there.

But then they learned that most pegeños did not see unpasteurized milk as unhealthy. They don't trust the government, so government warnings and directives carried little influence. They were also accustomed to the taste, appearance and smell.

To counter these perceptions and relationships, Lácteos initially sold their product at prices comparable to those of nonpasteurized products even though their costs were higher (at its lowest, the costs of pasteurization came down to 2.5 cents per cheese kilogram). The partners trusted that at similar prices and superior quality, customers would respond positively. This confidence was based on differences beyond health considerations: the nonpasteurized cheeses had hollows, were acidic, and had a strong odor, whereas their pasteurized cheeses were without hollows, tasted better, and maintained a fresh smell and appearance.

Pasteurization costs would not allow Lácteos del Pacífico to continue to match prices over the long term. But the partners expected that as consumer interest and appreciation increased (and perhaps as the new laws were enforced), they could gradually raise prices -- although they would continue to try to keep prices below those of the large national dairy firms.

It's difficult to estimate the market share and position of informal retailers, although Ruben knew one local producer as the informal leader who established prices which the two competitors followed. The intention of Braulio and Rubén was the one to create their own image and not to enter the pricing games of leaders and followers. This position would result in losing clients who demanded lower prices regardless of other considerations, but retain customers who would appreciate (and pay for) their product, and thus secure a viable niche.

### **SELLING TO INSTITUTIONAL CLIENTS**

With Institutional clients, Lácteos del Pacífico had the opposite problem. Clients wanted guarantees of health worthiness and legality. Both of these could be demonstrated by obtaining

compliance certificates from the Ministry of health and the Ministry of economy and commerce. The problem is that these certificates took 14 months or more, and that, in truth, Lácteos del Pacífico was not in compliance. Certification from the Ministry of economy and commerce required that no children or undocumented workers were employed. In fact, Lácteos' only reliable worker was from another country, and not properly documented. For the more important certificate from the Ministry of health, requirements included special water filters, which were costly, and which Braulio felt were not completely necessary.

Braulio was able to, for the time being, avoid these compliance issues by applying for the certification and obtaining temporary permits provided pending the on-site inspection (that were presently backed up 14-18 months). Given that his competitors had no certification at all, these temporary permits generally satisfied institutional clients, and served to differentiate Lácteos del Pacífico products from those sold by unlicensed retailers. Lácteos labeled their products "Pasteurized" conspicuously using labels provided by the pasteurizing equipment manufacturer to reinforce the hygienic advantage of their product.

## **THE SUPPLIERS**

Lácteos del Pacífico had to compete with both smaller retailers and Salguanica's three giant dairy companies. Their advantage was being the only producer of pasteurized products in Pegañal province, which allowed them to be the cost leaders (of pasteurized products) for the region.

The company employed thirty-eight milk suppliers. This way, they could avoid dependency on a few suppliers, and raw material costs could be maintained at a stable level. On average, suppliers obtained about 5.5 daily liters of milk per cow. Smaller farms delivered about 30 liters daily; larger farms brought in about 170 liters.

Regional demand of milk was fairly constant throughout the year, but supply was seasonal. To guarantee adequate year-round supplies, the partners cultivated two groups of suppliers: The "bajura" near the coast, and the "altura" in the mountains toward the center of the country. bajura production goes down in the brutal heat and humidity of the coastal summer; but altura production goes *up* in the temperate mountain summer. By using both types of producers, production could be leveled, with supplies available as production diminished in the bajura near the plant.

Rubén knew bajura producers from his raw milk business, but to purchase from altura suppliers meant competing with the national. It turned out that altura suppliers were happy to deal with Lácteos; the national companies demanded that producers both apply a cooling process which lasted between two to three days and subsequently deliver produce to their facilities. In contrast, Lácteos del Pacífico did not require cooling and arranged to pick up the milk themselves. As necessary, the partners also paid cash incentives.

Braulio had other “process management” ideas as well: One was to provide equipment, materials and training so that the suppliers themselves could analyze the raw milk for microbiological contents. This could both ensure that the milk arrived in good condition and thereby avoid returns and unnecessary processing costs. He also planned to advise suppliers on how to improve their yields through better grasses and food supplements. Braulio was especially interested in increasing the fat levels and proteins which would allow him to produce higher margin products. But neither of these plans had yet been implemented for lack of time and resources.

## **THE CRISIS OF AUGUST 2002**

When Braulio received his partner’s call, he left immediately for Pegañal. Upon arrival, he began to analyze the microbiological content of the raw material. He soon realized that the crude milk from one supplier was infected with mastitis<sup>2</sup>.

The pasteurization process annihilates more of 90% of the bacteria. normal crude milk has between 100,000 -150,000 bacteria per milliliter; milk contaminated with mastitis contain 1- 1.2million bacteria per milliliter.

They noticed that the product with the most problems had been sour cream, nearly all of which had been returned. Also some of cheeses were given back. The problem was detected on the distribution route that day, when store owners and some institutional clients complained of bad odors and leakage from sour creams and cheeses.

The most serious matter was that some of the store consumers had purchased and opened the products, which affected the reputation and the image of the store. Damaged product may have been also distributed on Monday and Tuesday. So both partners and the salesman left to gather all the lots that had been distributed on those days.

The salesman was optimistic that they were able to reclaim most of the products without some customers even realizing there was a problem. Braulio feared that the damage to his new business was extreme. He was aware of the challenges he would face to salvage the reputation of the company, and of the consequences that this could have for his own reputation. Although he was emotionally very disturbed, Braulio tried to think coolly about how he could have avoided this situation and what he had to do now with his clients, those who had detected the problem, as well as those that they did not know of the situation. He also began to wonder what would happen if some of the consumers became ill.

## **APPENDICES**

**Source** for all data: Escuela Nacional Superior de Agrónomos, Montpellier, France

### Appendix 1. Profit Margins in the Salguanica Dairy Industry (1998)

<b>PRODUCTO</b>	<b>Profit Margin</b>
Pasteurized Milk	2%

<sup>2</sup> Mastitis is an infection in the utter of the cow, which can produce pus, resulting in large quantities of bacteria and leukocytes in the milk.

Fresh Cheese	8%
Powdered Milk	12%
Ice cream cartons (½ gallon)	15%
Sour cream	25%
Ice cream pops (paletas)	30%
Ripened Cheese	42%
Butter (62.5 grs)	42%
Yogurt (22 grs)	48%

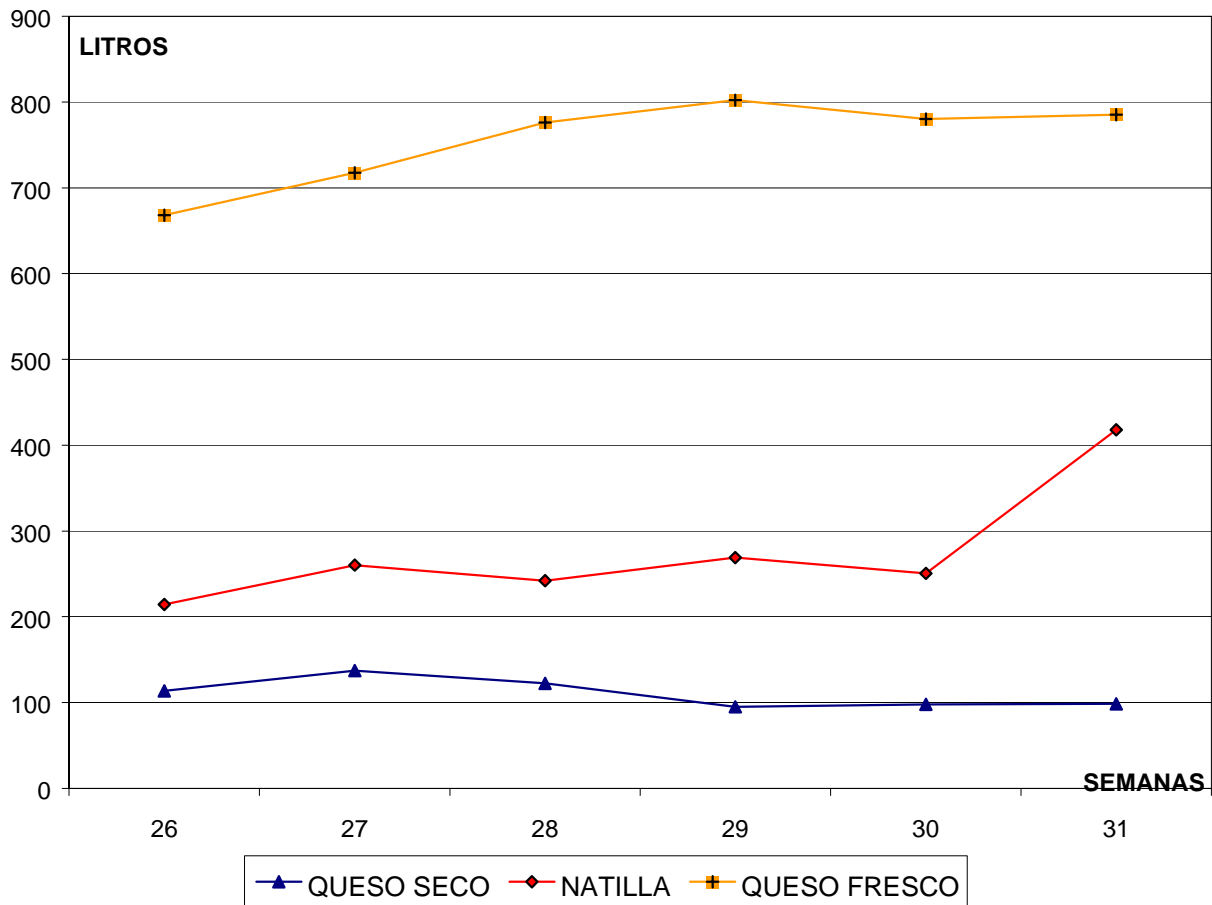
Appendix 2. Salguanica Dairy Per-Capita Consumption 1997-2001

Year	Annual Production Millions of liters	Population Millions	Consumption per cápita
1997	1,237	8.2	151.66
1998	1,296	8.3	155.82
1999	1,358	8.5	160.10
2000	1,424	8.7	164.50
2001	1,492	8.8	169.01

Appendix 4. Breakdown by Product Type in the Salguanica Dairy Industry

Product	% of Sales
Milk	41.4%
Powder Milk	9.3%
Yogurt	6.0%
Cheeses	19.0%
Ice cream	16.2%
Sour cream	4.0%
Butter & Lactose	4.1%

Appendix 6. Weekly production in Liters from Weeks 26 - 31 (2002)



#### Appendix 8. Variable Costs

	Percentage
Raw Materials (Leche)	75 - 78 %
Distribution	7 - 8 %
Gas, labor, etc.	14 - 18 %

#### Appendix 9. Cost Breakdown by Product Type in the Salguanica Dairy Industry

	Pasteurized Milk	Fresh Cheese	Yogurt	Sour cream	Butter
<b>Labor</b>	2%	5%	4%	3%	2%
<b>Raw Materials</b>	54%	56%	53%	42%	55%

<b>packaging</b>	13%	3%	26%	21%	3%
<b>Material spare parts, amortization of machines and energy</b>	6%	11%	6%	9%	6%
<b>Administrative Costs</b>	6%	7%	2%	4%	6%
<b>Distribution and promotion</b>	12%	12%	7%	16%	22%
<b>Financing costs</b>	7%	6%	2%	5%	6%

### Appendix 10. Tests to Ensure Product Quality<sup>3</sup>

Milk is submitted to several tests to determine if it is suitable for processing. These tests include the following:

Determination of the density: to see if milk is pure )

Point of freezing: indicates possible adulterations )

Determination of the acidity: Milk with a greater acidity of 0,18% is rejected

Precipitation with alcohol. mix equal amounts of milk and alcohol 68%. if coagulation takes place, the acidity is too elevated

Boiling. If milk coagulates during boiling, it cannot be pasteurized

Reaction with methylene blue. evaluates the degree of contamination with microorganisms.

Sedimentation. Filtering milk through a special cotton indicates impurity contents

Antibiotic presence

Germ content. High germ content indicates the presence of mastitis in the producing cows.

<sup>3</sup> Source: "Elaboración de Productos Lácteos: Manual para educación agropecuaria bajo la supervisión de la FAO."

## **Retention at FleetBoston Financial**

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### **ABSTRACT**

This case describes steps taken by FleetBoston Financial, a large financial services company, to increase employee retention in a highly competitive labor markets created by the economic boom of the late 1990's. In particular, the case focuses on how hr managers used the findings of two internal studies conducted by mercer consulting, a management consulting firm, in May 2000 and May 2001. The case is intended for use in a course on human resources management, particularly in a session dealing with either retention strategies or voluntary turnover. The case is based primarily on field interviews with managers at FleetBoston.

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It was May 2001, and Kajal Sen Gupta, Human Resources Director for FleetBoston Financial's tele-banking function, was looking for ways to improve employee retention in her line of business. Kajal was always looking for a way to increase retention; every HR initiative in the organization seemed directed at retention in one way or another. She had attended a presentation that morning by the head of human resources reporting, a group within corporate HR that managed internal data, and Kajal now had a plethora of numbers at her disposal: the drivers of turnover, the number of "quick quits", the state of local labor markets.

Overall, the presentation's message was clear. While FleetBoston was, on the whole, making progress toward improving retention of employees, voluntary turnover among call and operation center employees – these workers constituted the bulk of the employees in Kajal's line of business – was still very high. Indeed, over the two year period from January 1998 to December 1999, 21% of all call center employees left their jobs within the first three months, and 44% left within the first year. The numbers were compelling, but it would take some time to figure out what they really meant and what tele-banking's response should be. Yet, time was in



short supply. The bank had spent the past two years making and integrating large acquisitions. Competition for employees in most of FleetBoston's labor markets was intense, and Kajal felt strongly that HR needed to play a key role in adding value to the business. What role should this new analysis play in her response to the retention issue in her line of business?

## **BACKGROUND**

Founded in Providence, Rhode Island as Industrial National Bank, FleetBoston Financial had, by 2001, become the seventh largest financial holding company in the United States. It was a major player in the financial services industry with assets exceeding \$200 billion. A diversified financial services company, FleetBoston focused on four main lines of business: Retail Banking, Corporate Banking, Investment Services, and Latin America. The retail business, encompassing more than 1,500 branches and 3,700 ATMs, was the market leader in the New England and New Jersey markets. On the corporate side, the company was the largest bank-owned commercial finance provider and the fourth largest commercial and industrial lender in the United States.

The 1990's had been a period of consolidation in the financial services sector, and much of FleetBoston's growth had come through ambitious and high-profile acquisitions, including the purchase of BankBoston in the fourth quarter of 1999 and Summit Bancorp in the first quarter of 2001. In all, Fleet made approximately 150 acquisitions over a fifteen year period. These acquisitions left the company with a vast customer base, comprising more than 20 million customers in 20 different countries. However, the company needed to do more to extract profits from this customer base. For example, while Fleet enjoyed a dominant market share in New

England, servicing some 28% of households, it had only about 3% of those households' investible assets.<sup>4</sup>

By 2001, the company's leadership was determined to shift course and to focus on growing the company "organically" and on improving the company's customer service. Charles Gifford, COO and President, (who was slated to become CEO in the first quarter of 2002), envisioned a concerted effort to revamp the company's customer service approach. "We're going to try to make the customer feel better about the Fleet experience," Gifford commented, "We want them to feel that Fleet is an easy place to deal with."<sup>5</sup>

Central to this overarching strategy was a desire to improve the experience of FleetBoston's employees. The company employed a workforce of over 50,000 people (80% of whom were based in the United States), and the company's senior executives had begun to recognize the pivotal role played by FleetBoston's human resources function. Gifford explained:

There is no question that HR management plays a vital strategic role. Any leader who is perceived as being committed to the people who work for him has an enormous advantage. If employees walk around feeling pride in their company, that company can compete with anyone. We've only just started to scratch the surface in taking advantage of and investing in HR.

HR had had some success not only in improving the employee experience but also in fostering a more diverse workforce. The company was frequently recognized as an exemplary employer, being named one of the "top places to work" by *SmartMoney*, *CFO* magazine, *WorkingMother*, *ComputerWorld*, the Minority Black MBA Association, *Boston Magazine*, and the Gay Financial Network. Its Executive Vice-President of HR, Anne Szostak, was nominated for the 2001 Executive of the Year Award sponsored by *Human Resource Executive* magazine

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<sup>4</sup> Gene Epstein, "No Fleeting Fancy" *Barron's*, 31 December 2001, p.14.

<sup>5</sup> Charles Gifford, comments to the Human Resources Roundtable, Boston University, September 2001.

## THE MERCER STUDIES

Throughout the late 1990's, the principal human resources challenge facing Fleet (as the company was known prior to the BankBoston Merger) was the retention of employees. Strong economic growth, combined with the booming Internet sector, had increased the level of labor market competition in the New England area, and in particular, the technology-savvy employee favored by the financial sector was in short supply. Like other companies, Fleet was still creating new jobs at an unprecedented rate, and its competitive advantage relied on its ability to attract and retain talent at all levels.

In 1998, two trends within Fleet prompted the fresh look at retention. First, on the heels of a wave of significant acquisitions (including Quick & Reilly and Advanta), the HR function saw an opportunity to shift its attention from the integration of acquired companies to other fundamental organizational issues. Second, there was a growing awareness that the company needed to coordinate its response to labor market concerns. Ultimately, HR could not fight the retention battle on every front. As one manager explained, "We had to figure out where we were going to get the biggest bang for our buck." This meant encouraging line managers to safeguard the company's talent base and reduce the costs associated with turnover. Fleet's HR leaders were convinced that improving retention would require a shift in mindset among line managers. In the recent past, Fleet had addressed its cost concerns through downsizing, and as Szostak explained, "this corresponded with an attitude, among line managers, that people were generally disposable. But, we were in an active industry where good people were hard to come by. We were learning the hard way that no company can afford to throw people away."

## **The First Study: Mercer I**

Aware of the need to understand its internal labor market, Fleet's HR executives turned outside to Mercer Consulting's "Productivity Group". Fleet would become an early client in a growing practice that would eventually be able to benchmark staffing practices within industries and geographical regions. Initiated in the fourth quarter of 1997 and completed in May 1998, the Mercer study, targeted at Fleet's Commercial and Retail Banking units, had four objectives:

1. To determine Fleet's retention rate
2. To benchmark this rate against other companies
3. To identify the drivers of turnover at Fleet
4. To identify possible ways to improve retention at Fleet

In order to achieve these objectives, the consulting team proposed to understand the internal market dynamics and the external pressures driving turnover at Fleet. Rather than collecting new data or relying on traditional HR methods such as surveys, exit interviews, and focus groups, Mercer would derive their observations from statistical analyses performed on existing internal databases and available external data (e.g. census data). This approach would draw on previously disparate data streams that had never been fully appreciated. "There was a tendency," Anne Szostak explained, "to bury these numbers – turnover, salaries, performance appraisals – in various parts of HR. Mercer's job was just to put all of this together and to link it with data from outside the company." Mercer's methodology was straightforward – to build sophisticated regression models in order to predict turnover among Fleet employees – yet its analyses were well-beyond the competences of the internal HR function.

Ultimately, this quantitative approach boosted HR's credibility with the lines of business. Many line managers within Fleet and, more importantly, most of its senior executives were

highly suspicious of survey and focus group data. As one HR manager commented, “The mindset in the financial services industry is numbers driven, and if we were going to propose major changes in HR policies in order to reduce turnover, it helped to make our case using solid data.” The study had several headline findings:

**Voluntary turnover at Fleet was high, in comparison to other companies.** While Fleet had a total voluntary turnover rate of almost 27% per year, other companies in the banking industry had total turnover of only 16.3%. By comparison, the standard for all companies was approximately 13.2% (see Exhibit 2).

**Much turnover was concentrated among low performers.** As suggested by Exhibit 3, Fleet’s turnover rate was very high (over 35%) among the lowest performing employees but very low (5%) among high performers. In this sense, Fleet compared favorably with another regional bank which had its turnover somewhat more evenly spread out across performance levels.

**The factors having an impact on turnover were diverse.** Mercer grouped these factors in three broad categories: External Influences, Organizational Practices, and Employee Attributes. Among external factors, the most notable was the local unemployment rate in the area in which the employee worked. A one percentage point increase in local unemployment would drive down turnover by 1.1% in that region (see Exhibit 4 for more external data). Employee attributes also figured highly in determining whether an employee would leave. The groups most at risk were: employees under 30 years old, non-exempt employees, part-timers, males, those with shorter prior job durations, and those with college or masters degrees.

**A variety of HR levers could potentially impact turnover.** Based on the data analysis, Mercer proposed that changes in particular organizational practices could have a tangible effect on turnover (see Exhibit 6). The most promising “levers” included not only pay/rewards but also career development avenues and overall work environment issues.

### **Fleet’s Response**

Fleet responded quickly to the Mercer analysis. It was clear that the drivers of turnover related to nearly every facet of human resources management, and Fleet’s HR leadership began at once to incorporate action points growing out of the Mercer study into the HR strategy. The value of the Mercer data was, however, more than just analytical. HR made a concerted effort to disseminate the findings and to raise awareness among top management about the study. Previously, HR had little more than exit interview data and conventional wisdom – outside groups estimated the cost of a lost employee at anywhere from ½ to 3 times the employee’s annual salary – on which to build their case for retention efforts. Now, HR could “sell” the

importance of these initiatives using firm-specific data. The top management support garnered by the retention analysis provided a strong impetus for many related HR initiatives. These activities focused in the three main areas:

**Rewards.** While a key lesson of the study was that compensation was, by no means, the only significant driver, the bank moved to address reward inequities across regions that might have accounted for retention differences. In some front-line divisions, base salaries for certain markets were increased, including a change in the step progression that employees could expect to receive over time and more performance-based incentives.

**Career Development.** The Mercer study also prompted greater attention to career concerns. The data confirmed what HR managers had suspected all along: that career issues figure heavily in employees' decisions about whether to stay or leave. As Susan Treadway, Director of Human Resources Management Reporting, explained, 'It's a career issue.' We hear it every day. My department conducts daily exit interviews, and anecdotally, we already knew the power of career factors. Every quarter, we do a report on why people are leaving Fleet and every time it is lack of career opportunities or lack of awareness about opportunities available to them. The Mercer work allowed us to pinpoint the importance of career issues relative to other issues. It also pinpointed the two-year mark as a critical time for examining where employees stand and whether they are likely to leave the company. Following Mercer I, HR invested in improving its career development efforts. Where the bank had previously had no full-time career development person, Szostak hired eight full-time professionals, formed a new Career Development Office, and conducted a best practices review. Moreover, efforts were made to enhance the career path from non-exempt to exempt status.

**Work Redesign.** A central issue in the Mercer recommendations was the need to enhance employee skills through more effective work design. The analysis had suggested that 'internal job change' would account for a 6.8% decrease in the turnover rate; workload (in hours worked) also figured in the retention model. These findings led Fleet to focus on work groups could be more productive while (a) reducing the number of hours worked and (b) making that

work more satisfying for employees. In early 2000, Szostak invited the help of the Radcliffe Public Policy Institute – with whom Fleet had partnered previously (in 1996) – and developed a pair of pilot programs in which group process redesign allowed employees to reduce their hours, gave added responsibilities to administrative staff, and improved employees’ work/life balance. In sum, the impetus for better work design (as a way of increasing satisfaction and reducing turnover) translated into a strong commitment to work/life balance. As of early 2001, a Towers-Perrin benchmarking study of thirteen financial services firms ranked FleetBoston first in its programs for helping employees take care of dependents and fourth in work-time flexibility.

**Recruitment and Hiring.** HR also took steps to address the Mercer I implications concerning how they recruited and hired employees. For example, the Mercer data had demonstrated some impact on retention based on what channel (i.e. newspaper, employee referral, internet) was used to recruit an employee. Overall, employee referrals seemed to have a significantly better retention rate. Consequently, the company instituted incentive bonuses for employee referrals. HR communicated this program vigorously through internal newsletters and urged hiring managers to solicit referrals from their employees.

Concern about losing employees early in their tenure prompted several lines of business to take steps to improve the hiring process by revising the screening process and taking more time to evaluate employees. Other divisions tried to get managers more involved in the orientation of new employees, urging them to take more time to acquaint employees with the department and to discuss performance expectations.

### **The Update Study: Mercer II**

In late 2000, FleetBoston’s HR leadership asked Mercer to update its 1998 retention study. The update study would allow a progress check, testing the effects of changes following from the Mercer I. The second study had three main objectives: (1) to assess changes in which external and internal factors affect turnover, (2) to determine if the relative weight among retention drivers had changed, and (3) to explore, in greater detail, the turnover patterns across FleetBoston’s lines of business.

Another pressing consideration behind the decision to update the study was the BankBoston merger that had been completed in May 2000. The addition of BankBoston data to the Mercer study constituted a major shift and required much work just to incorporate the disparate databases. Fortunately, BankBoston had also been a Mercer client, and the consulting firm had produced some basic turnover analyses in branch operations and among exempt employees for BankBoston in September 1999 (See Exhibits 5, 7, & 8). Yet, a first glance at these comparative data suggested that the turnover patterns at the two companies were somewhat different. For example, turnover among exempt employees (see Exhibit 11) seemed to be concentrated at different salary grades, suggesting somewhat different career paths for managers.

The 2001 study also included a deeper analysis of Call and Operation Centers within FleetBoston. The earlier study had suggested that voluntary turnover was concentrated in the ranks of non-exempt employees; indeed, while the turnover rate among exempt employees was about 14%, voluntary turnover among non-exempt employees was 34%. Many of these non-exempt employees were involved in call and operation center work. As with Mercer I (perhaps to a greater degree), the corporate HR staff knew that the follow-up process would need to be primarily a grassroots effort. Over the years, the HR function had evolved into a relatively decentralized organization, with HR generalists serving as partners with line managers within each of the business units. This internal structure allowed HR to stay close to the business units and respond directly to their needs; however, as with Mercer II, this meant that the application of the data would rely on the energy that the data generated within individual lines of business.

### **TELE-BANKING**

The telephone banking (tele-banking) line of business was directly responsible for interfacing with customers. The call centers, located in Framingham, Providence, Scranton, and Utica, employed approximately 2000 employees and handled about 100,000,000 calls per year. Tele-banking included both telephone-based sales (*outgoing*) and customer service efforts (*incoming*). Specialized groups within tele-banking handled interactions with retail and consumer loan customers, premier customers (i.e. high net-worth individuals), and institutional



clients. The primary role of a tele-banking employee was to handle customer calls.

Approximately 200-400 employees per site spent the majority of their day on the telephone. In this productivity oriented environment, any time spent off of the telephones was considered *shrinkage*. As such, the two main challenges for HR were to ensure productivity and to maintain a high level of service quality. As one manager explained,

Basically, we need a workforce that can manage a lot of information on product offerings. We need people who are good at problem-solving, who can quickly address a customers needs. But in the end, we need people who can sit in a seat and handle their 100 calls per day. We hire, schedule, and plan based on the need to manage call volume.

The call centers maintained a highly professional atmosphere, and employees were given extensive training. Upon arrival at the call center, a new employee would embark on 2-3 months of training to familiarize them with the computer system, the telephones, standard protocol for handling customer requests, and basic problem-solving skills. After the initial training period, employees began to handle calls, receiving frequent feedback and evaluation based. Managers would occasionally monitor calls to assure quality of service. Even experienced employees spent much time assimilating new knowledge as they worked to learn about new product offerings and services. “Our agents have to be up-to-date on a lot of Fleet products,” another manager explained, “It’s a constant barrage of information, and they have to manage that in addition to answering calls all day.”

The Mercer II data had particularly attracted the attention of managers in the tele-banking business. Both Kajal Sen Gupta and Joe McGinnis, a line manager within the tele-banking line of business, had discussed the data with the corporate HR information reporting department. The new data drilling down into the call center workforce was “particularly interesting.” Within tele-banking, HR played an active role in partnering with business to address organizational concerns and to face issues throughout the traditional employee cycle, yet a significant amount of HR efforts were devoted to the “value-added” parts of HR. As Kajal Sen Gupta described the relationship:

We are closely aligned with telephone banking. HR works with the leadership group within the line of business, understands the business needs, and works out the HR implications based on that. I really try to reach out within the HR network, to different

specialists in the HR disciplines and draw in their resources. We are at the table most of the time on important business issues.

Of these issues, retention was the most pressing. Joe McGinnis commented: “Retention is still the big issue around here, and it’s the ultimate driver of most of our HR programs. And we certainly don’t have all the answers.” Still, there was no end to the number of suggestions floating around for improving tele-banking retention, and as McGinnis observed, “it seems like everything we do has retention as its goal.”

Among the ideas for reducing turnover, some had suggested traditional ideas such as job enrichment, in which the call center would address the repetitive and dull nature of the work. Others had pointed to the need to screen for employees that would be more likely to stay for at least three years. As one manager argued, “We need to spend much more time with candidates to let them know what the environment’s like. We can’t just sign them up as soon as they show that they can breathe and walk.” Still others imagined a career pathing program in which employees could continue to advance and, even in the case where call centers lost an employee, that person would not necessarily leave FleetBoston.

### **MOVING FORWARD**

In her meeting with Susan Treadway, Kajal Sen Gupta had gone page by page through the Mercer II report on call and operations centers, identifying those tables and charts with interesting findings (see Exhibits 13 through 18). In all, she had marked most of the pages in the booklet. Now, as she started to prepare for a meeting with Joe McGinnis and other line managers in her division, Kajal faced the somewhat daunting task of assimilating the data into a clear rationale and plan for action on retention.

She had three pressing concerns. First, amidst the myriad “drivers of turnover”, she needed to think about which would offer the most “bang for the buck” in terms of reducing turnover. Ultimately, the many possible initiatives would not all fit in with the variety of projects already underway in tele-banking. Second, there was a lingering suspicion that the Mercer data only told part of the story. Tele-banking had spent much time on “employee listening” efforts to understand concerns within the call centers. Mercer II had validated some of

these employee concerns. Yet, it did not seem realistic to expect that changing one or two things would “drive” the retention rate down immediately. Third, the larger economic scene was shifting. Interest in retention at the beginning of 2001 had been very high. However, the first signs of economic downturn had started to appear. As Susan Treadway had mentioned:

We’re trying to improve retention in an environment that will be increasingly dominated by discussion of cost-cutting. I think that’s the biggest challenge: How to frame the discussion of retention as being important in good times *and* in bad times?

Prioritizing retention would not be an easy sell in the current business environment. Still, given the costs of turnover, Kajal felt that retention was worth the effort.

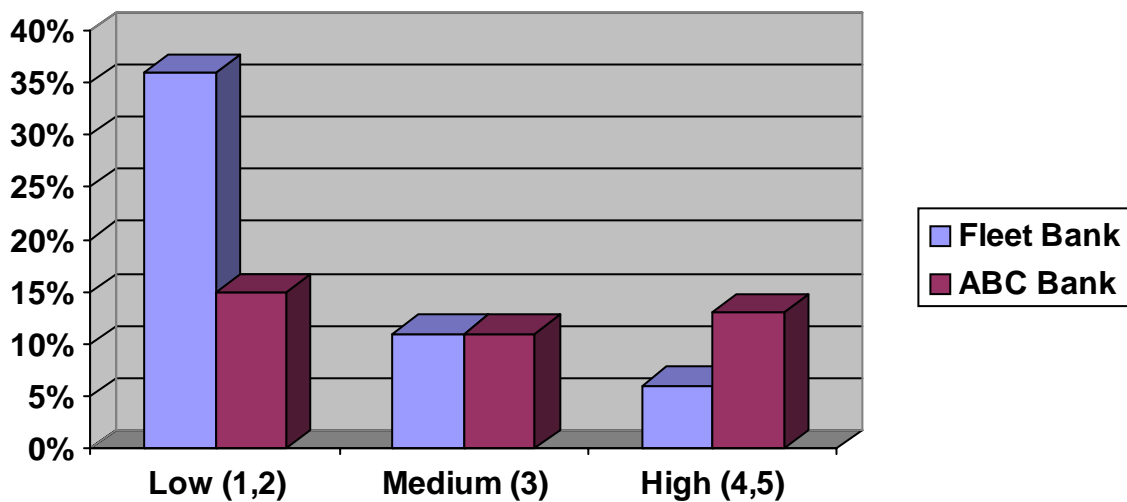
Exhibit 3. 1998 Benchmark Data

	Exempt	Non-Exempt	Total
Fleet	13.9%	34.0%	26.7%
Banking	10.2%	19.8%	16.3%
Non-Bank Financial	10.8%	17.7%	13.4%
All Companies	10.6%	14.2%	13.2%

(Sources: Mercer I; Saratoga Institute)

Exhibit 4. Turnover Rates Across Performance Groups (Compared with another regional bank)

**Turnover Rate**



**Performance Rating**

Source: Mercer I

Exhibit 5. Differences Across Geographical Regions

	<i>Voluntary Turnover Rate (2000)</i>	<i>Voluntary Turnover Rate (1998)</i>	<i>Unemployment Rate (1998)</i>	<i>Fleet Market Share (1998)</i>
<b>Boston Metro</b>	27%	22%	2-4%	20-30%
<b>Pittsfield MA</b>	N/A	17%	4-6%	10-20%
<b>Providence RI</b>	15%	11%	4-6%	>40%
<b>NYC Metro</b>	20-25%	31%	4-6%	10-20%
<b>Buffalo NY</b>	20-25%	26%	4-6%	10-20%
<b>Albany NY</b>	6-15%	17%	6-8%	30-40%
<b>Glen Falls NY</b>	15-20%	24%	8-10%	<10%
<b>Utica, NY</b>	30+%	18%	6-8%	10-20%
<b>Southern NJ</b>	20-25%	31%	6-8%	10-20%
<b>Portland ME</b>	20-25%	27%	2-4%	20-30%
<b>Lewiston ME</b>	25-30%	19%	4-6%	10-20%
<b>Bangor ME</b>	25-30%	34%	6-8%	20-30%

Source: Mercer I

Exhibit 6. Annual Gains for Reducing Turnover Among Full-Time Non-Exempt Employees

<b>This percentage-point reduction in turnover...</b>	5	10	15
<b>Yields this turnover rate...</b>	21%	16%	11%
<b>And these gains...</b>			
<b>Value added per employee</b>	0.4%	0.9%	1.3%
<b>Value added per employee</b>	\$506,284	\$1,012,568	\$1,529,624
<b>With this many fewer quits...</b>	47	94	142
<b>At this implied cost per quit</b>	\$10,772	\$10,772	\$10,772

Note: These calculations are based on 944 full-time, non-exempt employees in branch banking with an average salary of \$26,000. The relationship between turnover and value added per employee was established using a Granger causality estimate in which turnover in period 1 was used to predict business performance in period 2.

(Source: Mercer's 1999 BankBoston Analysis)

Exhibit 7. Impact of Identified Turnover Drivers

<b>Change in driver ... lowers turnover by ... % point.</b>	<b>1994-1997</b>	<b>1998-2000</b>
<b>Pay:</b>		
10% raise in base pay levels	1.3	0.3
If bonus received	6.8	6.3
Increase bonus for exempt from \$3,000 to \$10,000	N/S	1.3
1% increase in total pay from stock options	N/A	1.8
<b>Career Development:</b>		
If promoted	11.2	12.3
If previously non-exempt	3.5	6.2
If job changed last year	6.9	20.5
10 percentage points higher in base pay growth	6.6	8.9
1 year increase in FleetBoston tenure	0.5	0.4
1 year decrease in FleetBoston tenure	2.6	0.9
<b>Workload</b>		
10% reduction in hours worked to hours scheduled ratio	1.8	1.8
20% reduction in growth in deposits /employee	0.8	N/A
<b>Managerial Turnover:</b>		
If manager does not leave	2.7	3.8
If high-performing manager does not leave	3.9	4.3
<b>Location characteristics:</b>		
Location size of 35 instead of 15 people	N/A	0.5
Local office voluntary turnover decrease by 17%	N/A	3.4
Metropolitan area involuntary turnover decreases by 8%	1.6	1.3
<b>Diversity:</b>		
If white female (compared to white male)	0.5	2.9
If minority (compared to white female)	2.8	1.3
<b>Selection:</b>		
If high school (vs. college degree)	4.9	6.2
Increase in number of prior jobs from 1 to 2	1.9	N/S
Increase prior job duration by 1 year	0.4	N/S
Not acquired	N/S	2.1
<b>External:</b>		
1% increase in unemployment rate	1.1	2.2
Market share in county increases from 10% to 20%	0.9	0.6
Decrease distance to work from 8 miles to 4 miles	N/S	0.7

Note: The figure in each cell represents the estimated magnitude that a change in the driver would have on the turnover rate. N/S indicates that the estimate coefficient is not significant. N/A indicates that the variable was not available.

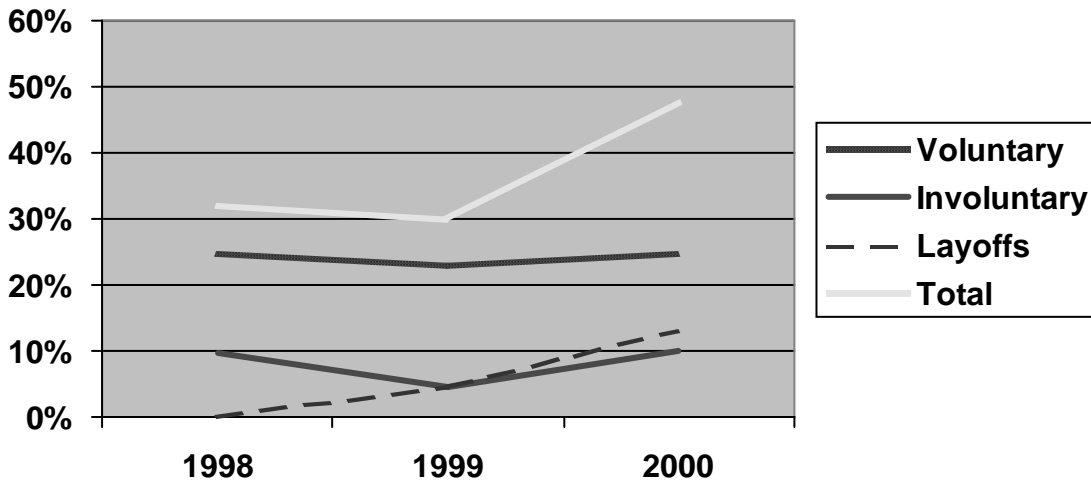
Exhibit 8. Drivers of Turnover at BankBoston 1999.

<b>Change in driver ... lowers turnover by ... % point.</b>	<b>1995-1999</b>
<b>External Influences:</b>	
BKB's share of county deposits doubles	1.8
1% increase in unemployment rate	0.8
<b>Diversity:</b>	
Increase in age from 30 to 40 years old	3.0
Female	1.3
50% less heterogeneity of jobs	1.2
Less variance of tenure	0.7
Minority (compared to white)	0.6
<b>Entry</b>	
Masters degree (compared to BA)	1.5
1 year increase in duration of prior jobs	0.4
<b>Staffing:</b>	
Not occasional	7.1
Never rehired	6.0
Full-time	5.1
Non-exempt	1.9
Not from merged bank	1.1
<b>Performance and longevity</b>	
Rated "Exceeds Expectations"	5.4
Rated "Meets Expectations"	3.8
Promoted	1.6
<b>Hours of work::</b>	
Increase of hours per week from 20 to 30	1.3

Note: The figure in each cell represents the estimated magnitude that a change in the driver would have on the turnover rate.

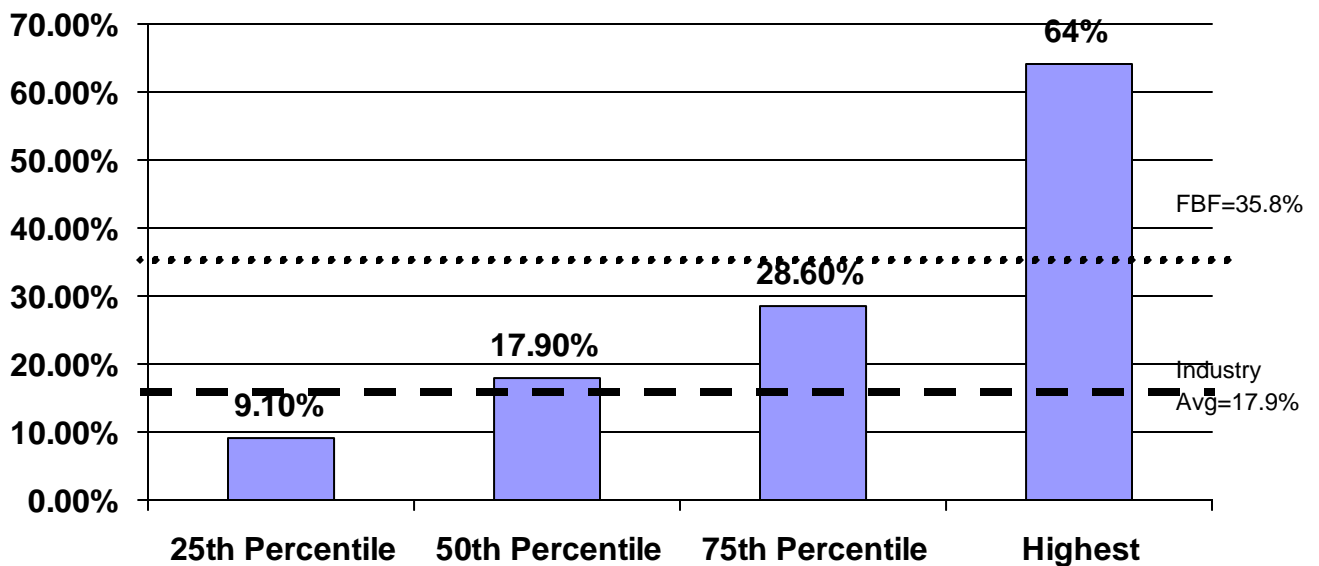
(Source: Mercer's 1999 BankBoston Analysis)

Exhibit 9. FleetBoston Overall Turnover



Source: Mercer II

Exhibit 10. 2000 Finance Industry Comparative Turnover Rates By Quartiles



Note: Based on Bureau of National Affairs (BNA) comparative data for the year 2000. Turnover in this chart is calculated as the sum of voluntary and involuntary turnover minus divestiture and severance programs. “FBF” = FleetBoston Financial.

Source: Mercer II

Exhibit 11. Pre-Merger Internal Labor Market Analyses on Exempt Populations: Fleet (1997) v. BankBoston (1998)

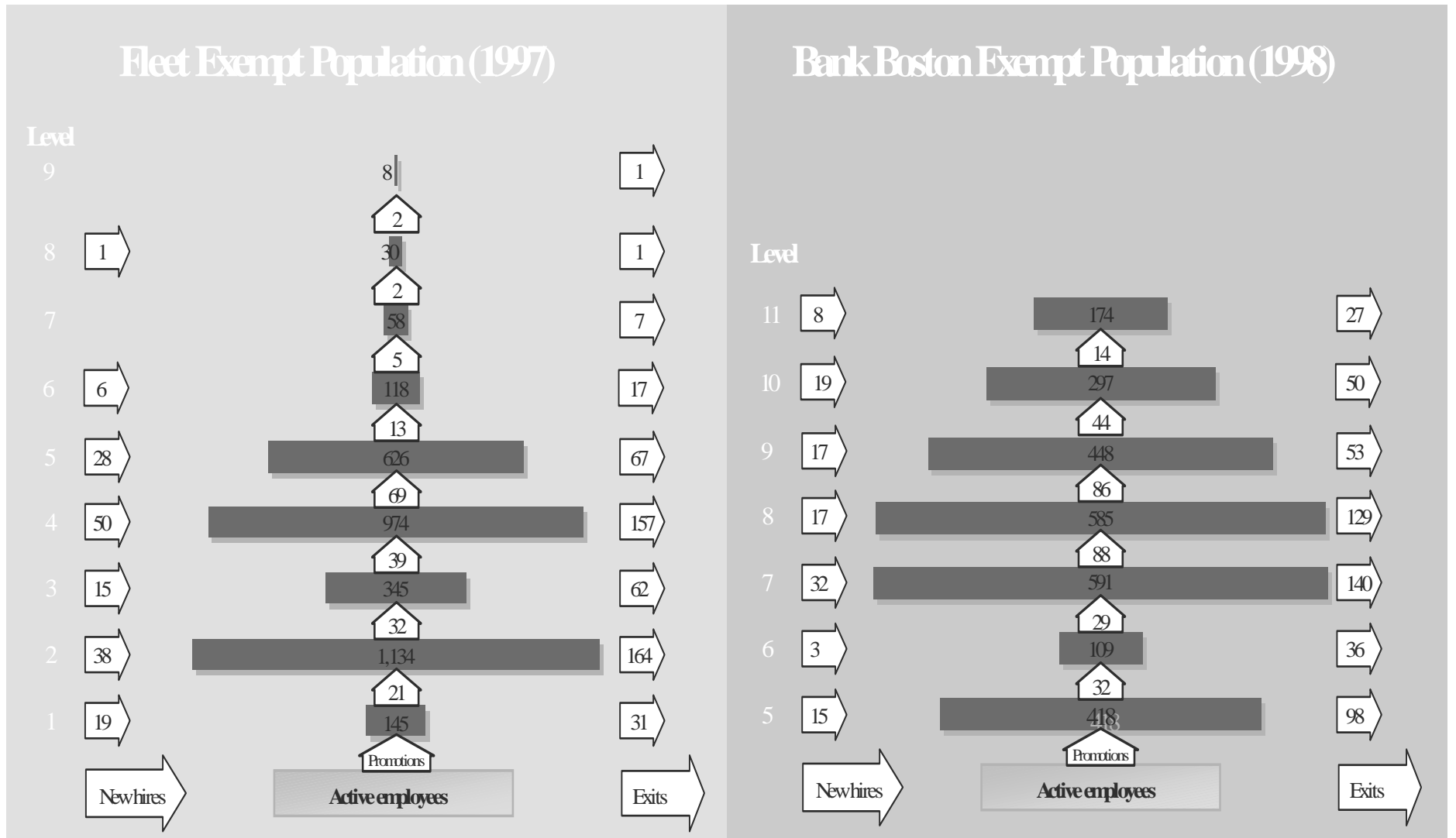
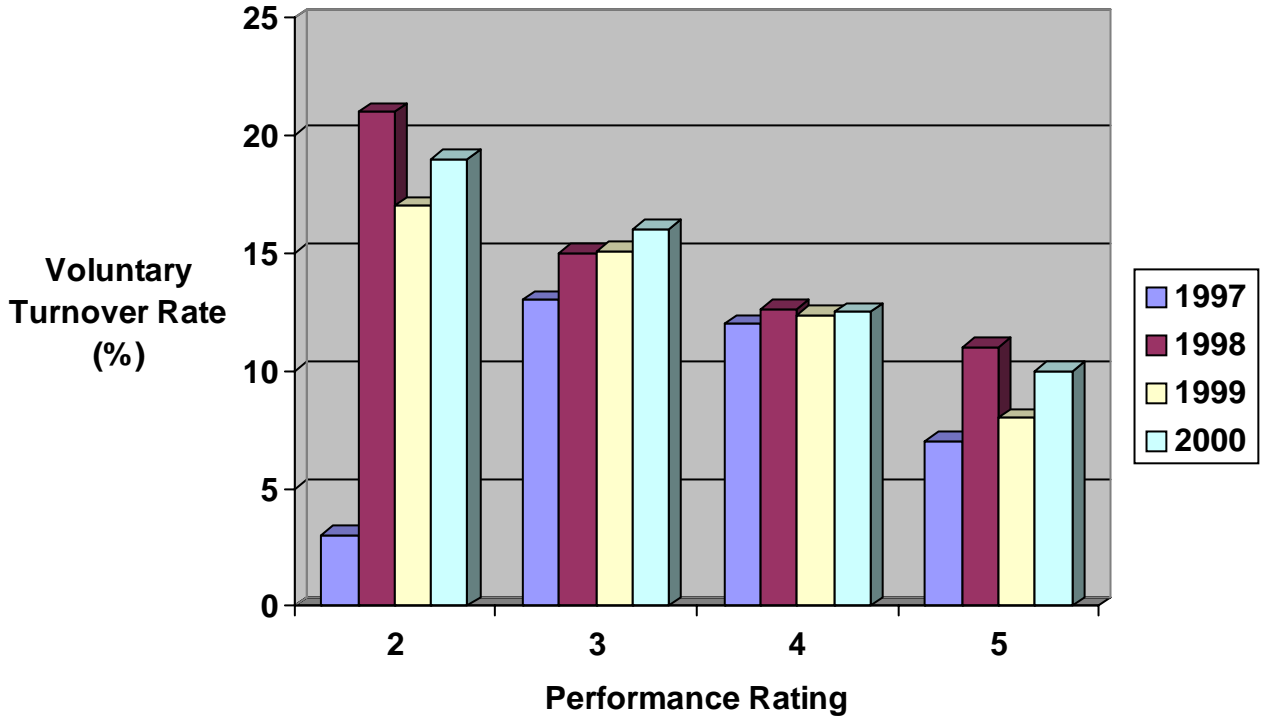




Exhibit 12. Voluntary Turnover By Performance Rating in Commercial & Retail Banking (Non-Exempts)



Source: Mercer II

Exhibit 13. 1998-2000 Voluntary Turnover rates

	1998	1999	2000
Commercial and Retail Banking	24.0%	24.0%	29.0%
Consumer Operations	54.0%	37.0%	35.0%
Global Markets	20.5%	15.0%	19.0%
Call Centers	36.5%	35.0%	59.5%
Wholesale Operations	13.0%	9.5%	19.0%
Global Service Operations	28.0%	19.0%	20.5%

Note: As of 1998 Retail Banking includes tele-banking, based on a company reorganization.

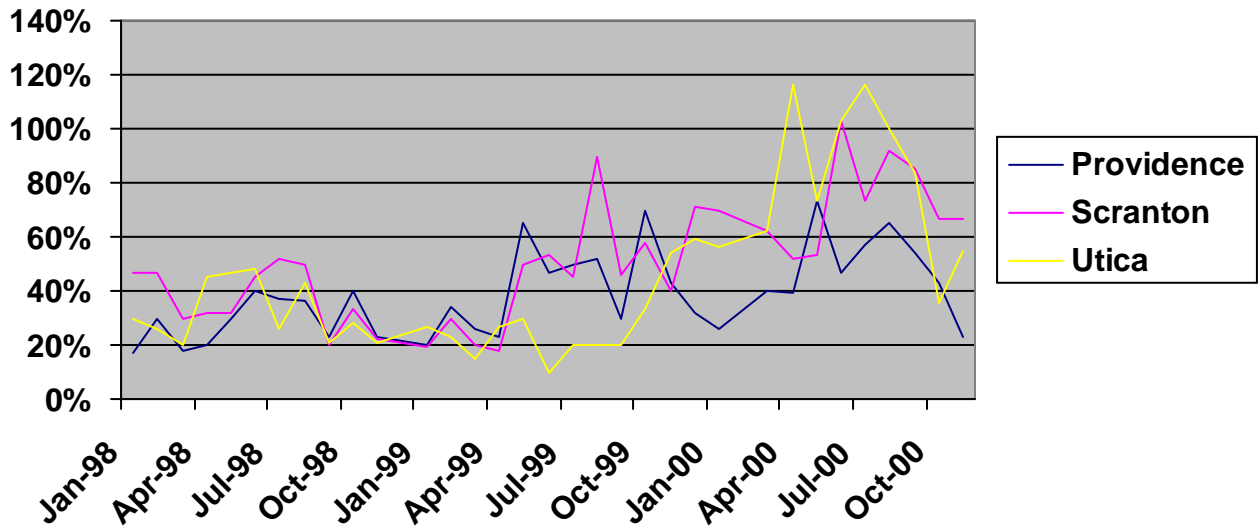
Source: Mercer COC Report

Exhibit 14. “Quick Quits” (Voluntary Turnover within the First Year)

	<b>Within 1 Month</b>	<b>Within 3 Months</b>	<b>Within 6 Months</b>	<b>Within 9 Months</b>	<b>Within 1 Year</b>
Commercial Banking (1997)	3%	4%	7%	11%	13%
Commercial Banking (1999)	2%	3%	5%	8%	15%
Retail Banking (1997)	4%	10%	19%	26%	33%
Retail Banking (1999)	7%	16%	26%	33%	38%
<b>Call Centers</b>					
Providence	5%	13%	22%	29%	35%
Scranton	13%	33%	45%	50%	54%
Utica	7%	36%	45%	53%	59%
<b>Operation Centers</b>					
Boston	19%	37%	51%	59%	64%
Hartford	14%	32%	47%	53%	58%
Providence	0%	0%	3%	7%	14%
Utica	5%	15%	23%	29%	34%

Note: Figures are cumulative and exclude all involuntary turnover. All call center and operation center data concern only non-exempt employees and reflect a 2-year period from 1/1998-12/1999. Other data reflect a one-year period from January to December of the year identified. (Source: Mercer II; Mercer COC Report)

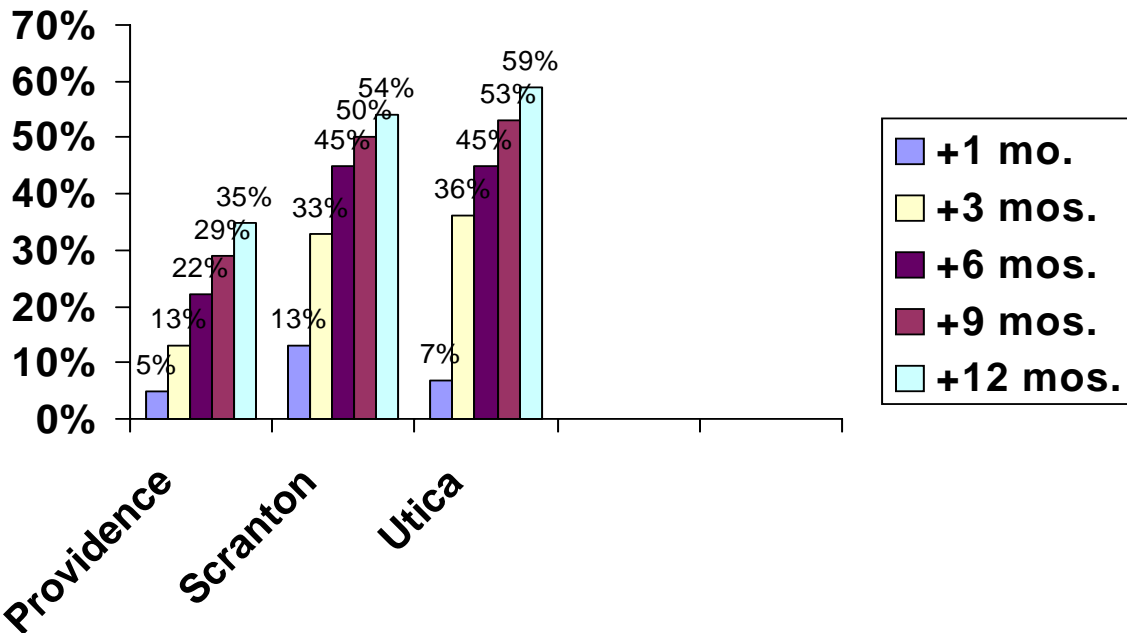
Exhibit 15. Call Center Voluntary Turnover Rates by Region.



Note: COC Report – “Annualized monthly rate (derived by multiplying monthly rate by 12). The monthly turnover rate is defined by the number of voluntary quits divided by the average of the beginning and end of month active employee counts. The turnover rate as of December 2000 is not presented, since data was not complete at time of data transfer.”

Source: Mercer COC Report

Exhibit 16. Call Center “Quick Quit” Rates (1998-1999)



Source: Mercer COC Report

Exhibit 17. Key Retention Drivers in Call Centers

<b>Change in driver... lowers turnover by... % point.</b>	<b>1998-2000</b>
Receiving bonus	23.0%
Internet v. Walk-in	21.0%
If promoted	20.5%
Referral v. Walk-in	20.0%
If supervisor does not leave	17.0%
Exempt v. Non-Exempt	16.8%
Referral v. Newspaper ad	7.0%
College v. Post-College	6.0%
Work in a department half the size of average department	5.0%
Doubling FBF branch size in a county	4.5%
Increase in number of prior jobs from 1 to 2	4.5%
10% reduction in hours worked to hours scheduled	4.0%
Supervisor's FBF tenure increased by 1 year	3.5%
Double bonus amount	3.0%

Note: Each figure represents the estimated magnitude that a change in the driver would have on the turnover rate. - Source: Mercer COC Report

Exhibit 18. Characteristics of Call Center Employees (December, 2000)

	<b>Non-Exempt</b>	<b>Exempt</b>	<b>Combined</b>
<b>WORKFORCE ATTRIBUTES</b>			
<b>Count (1)</b>	1,425	319	
Percent Full-time			83%
<b>Average Age</b>	34	37	
<b>Education – percent with:</b>			
HS Degree	76%	43%	
College Degree	14%	46%	
Post-College Degree	5%	7%	
<b>Racial Profile – percent</b>			
White	87%	94%	
Black	7%	4%	
Hispanic	4%	2%	
Percent Female	76%	63%	
Percent Married	37%	63%	
Average Commute – in miles	8.8	12.2	
<b>New Hires:</b>			
Average number of prior jobs			2.5
Average prior job duration			2.2
<b>CAREER</b>			
<b>Tenure – average in years</b>			
Position tenure	1.7	1.6	
FBF tenure	2.0	4.6	
Organizational tenure	2.6	6.9	
Average performance rating (1 = low; 5 = high)	3.3	3.6	
Percent promoted in year	18%	33%	
Percent rating 4 or higher getting promoted			32%
Percent receiving job change	39%	15%	

Exhibit 18. Characteristics of Call Center Employees (December, 2000) [cont'd.]

	<b>Non-Exempt</b>	<b>Exempt</b>	<b>Combined</b>
<b>COMPENSATION</b>			
<b>Pay Profile – avg. for year</b>			
Annualized base pay	\$20,167	36,473	
Base pay growth	7%	6%	
Percent base pay change with promotion			19%
Percent base pay change without promotion			2%
Bonus	\$773	\$2,896	
Bonus to total pay	4%	7%	
Percent receiving bonus	61%	85%	
Percent rated 4 or higher receiving bonus			92%
Percent receiving options	3%	34%	
Average option value			\$10,539
<b>INTERNAL &amp; EXTERNAL ENVIRONMENT</b>			
Workload: Hours worked/scheduled hours	86%	86%	
Supervisor Turnover			10%
Average home county unemployment rate	4%	4%	
Market share (branch banking)			14%

Notes:

Source: Mercer COC Report

## TEACHING NOTE

**ABSTRACT:** This case describes the steps taken by FleetBoston financial, a large financial services company, to increase its employee retention in the face of the highly competitive labor markets created by the economic boom of the late 1990's. In particular, the case focuses on how hr managers used the findings of two internal studies conducted by mercer consulting, a management consulting firm, in may 2000 and may 2001. The case is intended for use in a course on human resources management, particularly in a session dealing with either retention strategies or voluntary turnover. The case is based primarily on field interviews with managers at FleetBoston.

## LEARNING OBJECTIVES

This case was written for use in an MBA-level elective course offering an introduction to current issues in human resource management. The case may also be effective with undergraduate students, given the fundamental organizational issues at its core. The case serves three main purposes in a course on human resources:

- 1.) The primary objective is to develop students' abilities to summarize, analyze, and assimilate large amounts of data, thereby arriving at more informed human resources strategies. The HR managers at Fleet received a vast amount of information from the two Mercer studies. Their task was to cull its most important findings and to convert the insights into a workable plan of action. The case should allow students to engage in a similar task, thus developing important analytical skills.
- 2.) The case also motivates a broader discussion of the importance of retention at FleetBoston. While constrained labor markets have made recruitment and retention difficult, changes in the economy and other company –specific factors raise the question of whether retention should continue to be a priority at FleetBoston. In answering this question, students should develop their ability to evaluate the strategic importance of an HR issue, given the external environment and the company's strategic objectives.
- 3.) The case concludes by suggesting that students prepare, as Kajal Sen Gupta was doing, a brief presentation (to be given to line managers within tele-banking) outlining the "headline results" of the Mercer study and an action plan to address retention. Doing so will allow students to develop communication skills and will give them experience with a very common task for HR generalists who work in direct partnership with line managers.

## PREPARATION

The case itself sets forth three questions to assist in student preparation. These do not exactly match the flow of the teaching plan below but prompt students to think about key issues prior to the class discussion. Students are asked:

- (1) How is FleetBoston doing in its efforts to improve employee retention?
- (2) What are the key implications of Mercer II for tele-banking?

(3) What steps should Kajal Sen Gupta recommend to improve retention in tele-banking?

Though not explicitly included in the case text, we would recommend an additional assignment for students to complete in preparing the case. Given that the case focuses on Kajal Sen Gupta's preparation for a meeting with her line of business partners, it may be interesting to require students (in small groups) to prepare a brief presentation – perhaps including 3-5 overhead slides – in which they summarize the important findings of Mercer II, explain the strategic importance of retention to the division, and outline action points based on the study.

The central issue in this case is that of employee retention. The instructor may find it helpful to review some background readings on this subject. Particularly provocative is Mitchell, Holtom, and Lee's (2001) *Academy of Management Executive* article, entitled "How to keep your best employees: Developing an effective retention policy" ( vol. 15, no. 4, pp. 96-109). Currently, the most useful review of the scholarly literature on turnover is Maertz (1998) "25 years of voluntary turnover research: A review and critique", in Cooper & Robinson *Int'l Review of Industrial and Organizational Psychology*, London: Wiley & Sons, pp. 49-86.

### **TEACHING PLAN**

This plan is prepared for a two-hour teaching session We begin the session by summarizing the context for the case: FleetBoston has, in less than twenty years, gone from a small, Providence-based regional player to the seventh largest financial holding company in the U.S. They have done this by making 150 acquisitions in a fifteen year period. Moreover, both the company and the business environment are in constant flux. As of May 2001, the company had only just completed another massive acquisition (Summit Bancorp), and HR was still coming to grips with the BankBoston merger. They also had some inkling that the economy might be starting to turn. In this context, we point out, stock HR issues like retaining employees take on a whole new level of complexity. We then ask a simple question, "How is FleetBoston doing in its efforts to improve employee retention?"

#### **1. How is FleetBoston doing in its efforts to improve employee retention?**



- What do the numbers tell us?
- How well have the specific policy steps worked?

Based on the facts in the case, students should be able to generate a reasonably good comparative picture. Observations can be grouped in four main categories: comparative differences between the results of Mercer I & II (i.e. change from 1998 to 2001), benchmarking against external companies, changes in the magnitude of certain drivers as predictors of turnover, and changes in the pattern of “quick quits” (i.e. those that leave the company within the first year of employment). The instructor may wish to record the main points of this discussion on the blackboard (see Exhibit TN-1).

The value of this initial discussion period is twofold. First, students must begin to go beyond generalities (i.e. “Fleet is doing well/poorly.”). In the course of the discussion, the instructor may press individuals to dig deeper into the numbers to substantiate their views more thoroughly. Second, students should come to see the diversity of performance standards and measures. While Fleet’s overall retention numbers have not improved – turnover actually jumped sharply – the picture is most certainly more complicated, given the labor market pressures, the differences among regions, and the BankBoston merger. In some cases, the magnitude of certain drivers changed significantly from one period to another, perhaps reflecting the effect of some intervention.

## **2. How important is retention at FleetBoston?**

- What are the disadvantages (and advantages) of turnover?
- How does it fit with the current business environment?
- How does it affect the company’s strategy?

It is important for students to make a case for retention at FleetBoston. This is a more complicated task than students may realize, and it may help to prompt the discussion by probing students for the advantages and disadvantages of retention. These can be listed on the board.

The facts in the case should prompt a reasonable summary of general pro's (e.g. the cost of hiring and retraining employees) and con's (e.g. the ability to get rid of low performers). Two points that may require additional prompting are: (1) the negative impact of turnover on customer service in branches and other front-line jobs and (2) the positive short-term impact that turnover can have on a manager's financial performance. On this latter point, the instructor may decide to press one the more sanguine pro-retention students to state their case more convincingly as if speaking directly with a line manager. As one FleetBoston manager commented, "When you talk about retention with line managers, they'll sometimes come back and say, 'Are you kidding me? The turnover is actually helping my numbers!'" There are, of course, counterarguments to this (short-term v. long-term benefits, the loss of value-added when an experienced employee leaves, etc.), and the student should try to make the case forcefully.

At some point, the discussion should focus on Fleet-specific matters. If the conversation remains general for too long, we might ask the question again, emphasizing the word 'at FleetBoston'? The point is that turnover may be good or bad, and HR efforts to encourage retention must fit with the overall company strategy. We might ask: "What is FleetBoston's strategy as of May 2001, anyway?" The company is, after all, trying to grow by improving its customer service focus, and the customer experience turns, to some degree, on building regular interactions with specific employees. At the same time, the importance of retention does depend on what is going on in the larger business environment: the labor market, the economy, etc. A final point, here, is that retention at FleetBoston may be important in pockets – e.g. front-line, non-exempts – but less so in other parts of the bank.

Ultimately, despite allowances for business cycle effects, students should come to appreciate: (a) that retention is necessary for the long-term value of the organization, (b) that retention of high-potential employees continues to be a top priority at FleetBoston, and (c) that differences exist across lines of business. The fact that, even in the worst times, the hiring freeze did not extend to Call and Operation Centers should indicate the radically different concerns in those units. HR managers at FleetBoston saw interest in strategic retention initiatives

diminishing as economic concerns grew, and managers like Kajal Sen Gupta needed to build a persuasive case for these initiatives.

### **3. How confident are we about the Mercer numbers?**

- How did they arrive at these numbers?
- What are some of the problems with their approach?

At some point in the discussion, students will likely raise the methodological question: Are we reading too much into the Mercer numbers? At whatever point this question is raised, we find it useful to take a moment to consider the wisdom of basing policy decisions solely on the data concerning drivers of turnover. This is a good opportunity to address two major points. First, the instructor may ask students to explain how Mercer arrived at its numbers. This discussion may be more or less detailed depending on the time allotted and the quantitative skills of the class. Simpler concepts such as turnover rate should be intuitive. While students need not understand logistic regression, they should understand (a) that the data points are individual employees, (b) that the outcome being predicted is whether or not they leave during a particular period, and (c) that the “drivers” are the factors that predict the outcome. Ultimately, a very practical takeaway from this case is that students might be able to request (not necessarily do) similar internal analyses when put into an HR management position.

Second, students, especially those with some background in introductory statistics, should raise a number of issues in response to this question. The concerns vary in terms of sophistication, and students may need to be prompted to arrive at the latter issues:

- There may be other variables that would be helpful for making policy-oriented decisions. Since students, like managers, will often claim to “need more data” (even in the face of overwhelming data such as that provided in the case), it may be useful to keep a list on the blackboard of “Other things we want to know...”.
- There is a definite need to cross-validate the Mercer findings with qualitative and quantitative data available through other internal reporting. This was actually a major concern within tele-banking, where HR managers felt that the numbers served mostly as validation of insights gained through “employee listening” and other anecdotal evidence.

- Comparative data across timeframes (i.e. across the 1998 and 2001 studies) can be especially misleading. As Mercer consultants clearly indicated during their own presentations, estimates of turnover depend on the model specifications and the employee populations on which they are based. The most notable concern here is that the acquisition of BankBoston, which brought thousands of new employees into the relevant population, could account for most if not all comparative changes across time periods. In response to this concern, it may be interesting to have students draw on the data from the BankBoston 1999 Mercer study (case Exhibits 5, 7, 8, & 11) to note the ways that adding the merged employees to the population may have shifted the findings.
- There is an important distinction between those drivers that are statistically significant and those with significant effects. Statistically, the coefficient for any given predictor is likely to be significant simply because of the huge sample size involved. As Mercer tended to point out, it is important to look at the magnitude of the effect – i.e. the amount of change in the studied behavior following a change in the driver. In the discussion, we might ask, “How many of these drivers are actually important?” In most cases, this should probably limit the wise manager’s focus to the first 4 or 5 drivers on the list.
- The impact of changing multiple drivers cannot simply be added up, as changing one driver can affect the value of other drivers. This interaction effect may prove either *synergistic* (i.e. combinations of changes could result in a larger impact than the sum of the individual drivers) or detrimental. Ultimately, HR managers must develop some ability to theorize about how drivers may work together, and the instructor may spark an interesting discussion by pressing students to imagine which drivers may interact.

#### **4. What are the key implications of Mercer II for tele-banking?**

- How are the call centers doing in retaining talent?
- How important is retention for the call-centers?
- What actions should be taken?

In the second hour of discussion, we deal directly with the problems confronting the tele-banking division. At this point, if the optional assignment has been given (and depending on how much time is available), groups of students may give their brief (5-10 minutes apiece) presentations to the class. To prevent redundancy, the instructor may wish to have groups present on different topics (i.e. some of the groups present only their answer to discussion question 2). Thus, three distinct presentations can be given: Why is retention important for tele-banking? Why is tele-banking’s turnover so high? What actions should tele-banking’s managers take to improve retention? During these presentations, the instructor and the rest of the class may be cast in the role of the skeptical line manager, raising challenging questions about the

study, its implications, and the group's recommendations. If the presentations are not used, the remainder of the discussion of tele-banking can be structured around the same questions.

**Why is retention important for tele-banking?** It may be instructive to have students, individually, try to persuade each other of the importance of retention in a role play between the HR generalist and the line of business manager. Many of the costs and benefits of turnover listed on the board in the earlier discussion apply readily to tele-banking (i.e. hiring costs, training costs, service quality, etc.) Listening to students making their case, the instructor may circle those arguments that the “managers” find most persuasive.

At some point during this discussion, the instructor may ask, “How long do we want these people to stay?” After all, an important point that needs to be brought out, in regards to tele-banking, is that the goal is not to keep an employee answering phones forever. While “quick quits” during the year-long training and probationary periods (detailed in the case) are costly, the expectation is that the ideal employee will only stay in the role between 2.5 – 3 years. After this, the repetitive nature of the work tends to cause burnout (though when this occurs in the call centers has not yet been fully studied). It may be helpful, turning to the blackboard, to map out the career of a call center employee (see also Exhibit TN-2 which shows our diagram of the call center employee life cycle).

A critical point on which to press students is the cost of losing a call center employee. There are many ways to estimate this cost; indeed, the cost of retention is a veritable holy grail among HR managers and scholars. Some students will no doubt balk at the imprecision of the task; however, since we're not trying to build a bridge, we can live with rough estimates. One approach (using the conventional benchmarks mentioned on page 4 of the case) is to estimate based on a percentage of salary; given an average salary of about \$30,000, this would place the cost (largely in terms of training costs and hiring a replacement between \$15,000 and \$75,000).

The case data affords other avenues for “back of the envelope calculations. For example, a simple calculation, based on the number of “quick quits” in call centers (44% leave after one year) and the average position tenure (1.7 for call center non-exempts) suggests that the average

non-“quick quit” is only staying in their position 2.25 years. This is at least three to nine months less than the optimal range described by the life cycle. If we assume that the employee who left is immediately replaced by a new one (who spends 3 months in training and 6 more producing sub-optimal value-added results) and if we use one of the available estimates of per employee value added in the case, we find that each month of retention is worth a substantial amount of money.

Ultimately, students should recognize the call centers as one of those pockets in which retention remains a company priority despite the economic downturn. As one HR manager explained:

Frontline customer service people...we're not talking about freezing that part of the workforce. We're doing everything we can to do keep those positions staffed, and anything that we can do to reduce the hiring and training costs by improving the retention picture – even if it's only by a few months for a particular person. That's worthwhile.

**Why is turnover so high in tele-banking?** Here again students may offer various hypotheses based not only on the drivers but also on the comparative data. Some comparative data are available from one period to another, but one of the more interesting issues is variation across sites. As we teach this case in New England, it is fun to ask, “What’s so different about Providence?” The case data support some hypotheses. Fleet has dominant market share in Rhode Island; it was also founded in Providence and has a great deal of prestige as an employer there. There may also be cultural differences. In any case, students may include “what’s going on in Providence” among the “Things we still want to know...” on the right-hand board. Students should also gain some intuitive sense of the “type” of person that works in a call center. Here, we are not talking about the post-MBA, high-potential exempt employee typical of studies in career dynamics. At most (but not all ) sites, these are non-exempt, high-school educated workers. Knowing this may lend insights into patterns in the turnover data. For example, the monthly turnover rates seem to cycle both with the school year and the holiday season.

**What should be done?** The final part of the discussion (whether prompted by the presentations or not) should focus on action planning. Students should begin to list proposed

actions that tele-banking can take to reduce retention. In facilitating this discussion (and recording the solutions on the board), we find it important to keep a check on three tendencies.

- The first is for students to want to work on every driver at once. It may be helpful to press students, after each point, to determine how reasonable it is to expect a given situation to change. For any given driver (e.g. promotions, salary increases), the question is, “Is it reasonable to change this driver and still keep the call center functioning?” In some cases, data provided in the case demonstrate the limits of a given lever. For example, labor market data make it clear to changing the demographics or size in a given site through selection criteria may or may not be feasible.
- The second tendency is to remain too general. For FleetBoston managers, one of the most attractive facets of the Mercer analysis is the ability to make targeted interventions. When students propose changes, it may help to push them to tailor them more specifically to certain sites.
- The third tendency is to bow to “forces beyond our control”. A significant minority of students will probably tend toward the opinion that some of the external drivers of turnover are well-beyond HR’s ability to intervene. For example, if FleetBoston does not have the market presence in Scranton to give employees the status they need, HR can do very little to increase market share. These students should be urged to think more creatively about actions that might lead to the same sense of status that Providence employees may derive from working for Fleet.

### **TEACHING SUGGESTIONS (CLOSING SUMMARY)**

We summarize around three major points. The first is that FleetBoston Financial’s experience with Mercer’s strategic retention analysis is representative of a new direction in HR. With the increasing power of information technology, the vast amount of data available in most large companies, and the sophistication of statistical software, such analysis can and should be as powerful a tool for human resources decision-making as it has long been for finance and marketing managers. In short, work such as that at FleetBoston may go a long way to squelch the age-old accusation that HR is a “soft” discipline. At the same time, FleetBoston’s experiences should be instructive of both the advantages and disadvantages of relying on such analyses. The old saying, “There are three types of lies – lies, damn lies, and statistics”, comes to bear in this case. The potential weaknesses of the Mercer analysis are not insignificant, and the HR manager must be an educated consumer of such analyses and must work to educate those line managers to whom they are “selling” this information. Statistics are only as good as the

strength of the logic with which they are interpreted. For example, claims that the effectiveness of FleetBoston's response to Mercer I are 'clearly' evidenced (or not) in the Mercer II data merit serious questioning. In the end, the more a manager relies on this sort of analysis and the more these data are available, the longer the list of "things we don't know yet" should grow.

Second, voluntary turnover is a strange and elusive phenomenon. The drivers are numerous and diverse, and the causal link between a single factor and the decision to leave one's job is hazy at best. Also hazy are the relationships between management interventions and the reduction of turnover in an organization. The farther analysis gets from the individual decision-maker, the more attenuated the causal effects become. Thus, addressing turnover and retention requires a greater attention to detail than many companies have achieved. The old formula – "intrinsic & extrinsic rewards lead to satisfaction which lead to retention" – is an insufficient guide. FleetBoston's efforts were most interesting when they achieved a high level of specificity. For example, in reviewing the relative effects of reward systems and comparing the pay averages within specific geographical regions, HR was able to address problems with the reward system in a targeted way. Similarly, the information on promotions as a lever were useful not because HR managers envisioned giving out promotions more liberally but because they demonstrated a two-year time frame (within certain demographics) after which career issues like promotions become more salient to certain types of employees. Career development officers could then adapt their interventions to accommodate such concerns. This level of detailed insight guide and targeted intervention increases the odds that the company will address the concerns of the given individual that may or may not be considering a departure.

The third lesson is that, as a rule, "selling" HR issues to line management is never easy. At every level, HR managers at Fleet – be it Anne Szostak at the corporate level, Susan Treadway in an internal HR support function, or Kajal Sen Gupta partnering within the line of business – needed to communicate the importance of HR issues in terms of their impact on business and with the credible evidence that business leaders could grasp. The Mercer data was powerful; however, its usefulness depended on the managers' ability to interpret it. At



FleetBoston, it quickly becomes clear how vital it is to have a sense of how much it costs a given business to lose a “quick quit” employee, how retention fits into the larger business strategy of the company, how proposed interventions would fit with other people-oriented initiatives in a line of business, how the operations of a call center affect the range of solutions available for addressing turnover. Gaining this knowledge requires an intimate understanding of the business and how it works; any HR manager that hopes to partner effectively and convincingly with business leaders must develop this knowledge and the communication skills needed to convey it.

Exhibit TN-1. Board Plan

Board 1

Retention at Fleet

Benchmarking

1998 → 2001

Specific Policies

"Quick Quits"

Left Board

T-B Employee Life Cycle...

- Training (2-3 mos.)
- Getting up to speed
- Review (6 mos.)
- "Seasoned" (12-18 mos.)
- Burnout?

Board 2

*The Case for Retention*

<u>+'s</u>	<u>-'s</u>
turnover costs	cost savings
labor market	unavoidable
customer service	get rid of low performers
FBF-specific factors?	
-new customer service focus	
-constrained labor market	
-adequate of retention resources	

Right Board

Things we still want to know...

Providence?

Optimal range

Burnout study

Tele-Banking

How are we doing?

Drivers?

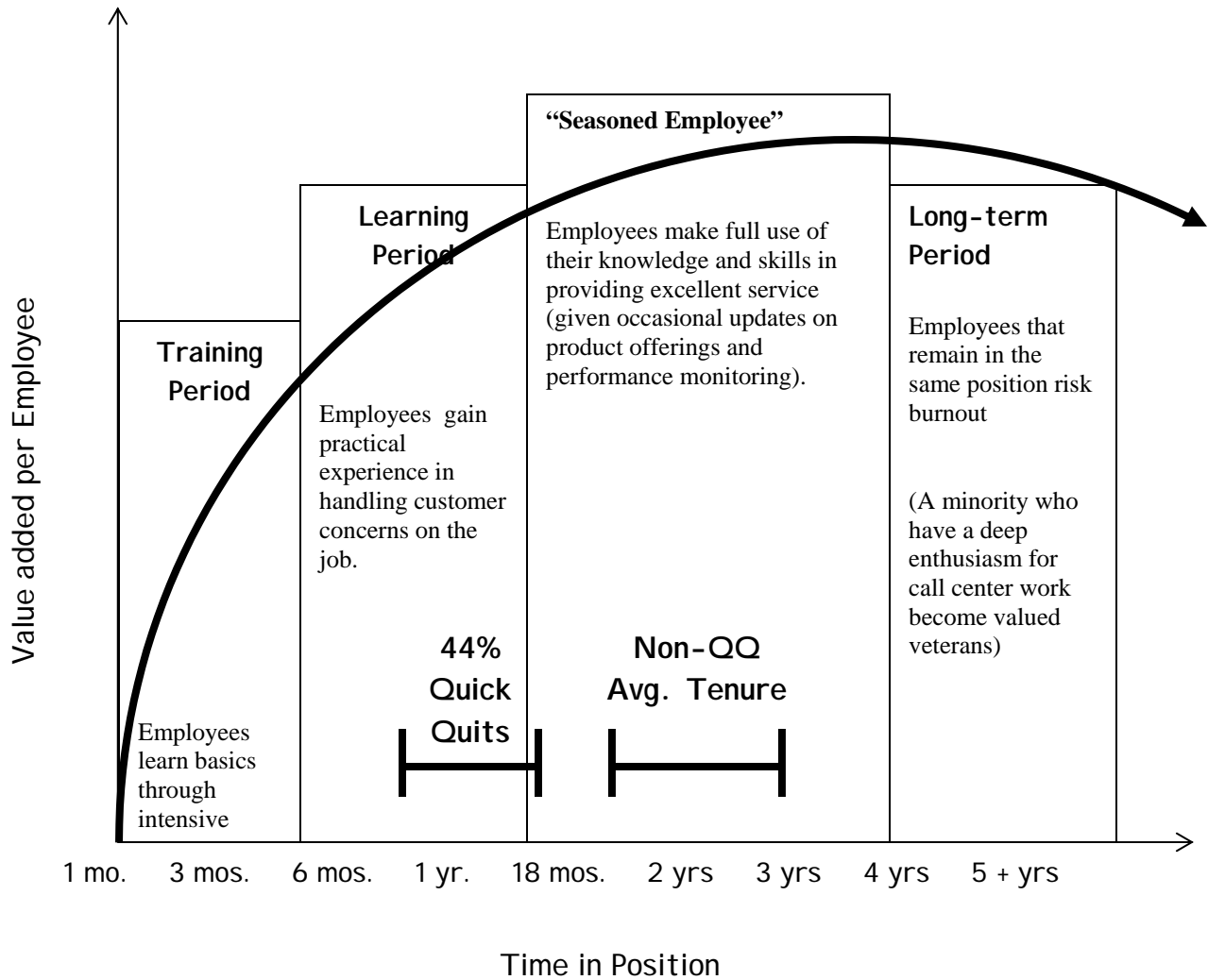
Differences...

Hiring Method

T-B Action Plan

Driver → reasonable? → specific action

Exhibit TN-2. Call Center Employee Life Cycle (devised by casewriters)



## **REGULAR CASES**

## 100 Years of Ford: From Dominance to Death?

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### ABSTRACT

In its centennial year, Ford, the company that revolutionized car production in the world is facing doubts about its existence. There are rumors about the possibility of Ford filing for chapter 11. From a company sitting on a overwhelming \$23 billion cash reserve in 1998 and optimistic about ousting General Motors from its leadership position, Ford is now looking at red ink and its bonds poised on “junk” status. William (Bill) Clay Ford Jr., 45 (the great grandson of Henry Ford who founded Ford Motor Company), appointed chief executive of Ford Motor Company after ousting of Jacques Nasser in October 2001, faces the monumental task of reviving the world famous carmaker from the brink of death. Launching a ‘back to basics’ campaign, Bill Ford believes that the company can be returned to its heyday and make the ‘blue oval’ shine again. There is mounting pressure from increased competition, declining market share, poor cash situation, large unfunded pension and retiree medical liabilities and above all, a top management work at odds rather than as a team. Quality improvement programs have stalled and new product introductions are being delayed. The share price has gone down as low as \$6.60 in March 2003; the company slipped from a zenith to a nadir in just a span of three years. A poorly led ambitious transformation, loss of focus on the core business operations, poor product quality, loss of employee morale are some of the key factors the led to loss of Ford’s dominance in the automobile market.

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### Introduction

In its centennial year, Ford, the company that revolutionized car production in the world is facing doubts about its existence. There are rumors about the possibility of Ford filing for chapter 11. From a company sitting on a overwhelming \$23 billion cash reserve in 1998 and optimistic about ousting General Motors from its leadership position, Ford today sees red ink with its bonds poised on junk bond status<sup>6</sup>. William Clay Ford Jr., 45 (the great grandson of Henry Ford who founded Ford Motor Company), appointed chief executive of Ford Motor Company after ousting

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<sup>6</sup> Muller. J., Kerwin. K., Welch. D., Moore P. L. & Brady D. 2001. Ford: Why it’s worse than you think? *BusinessWeek Online*, June 25, [http://www.businessweek.com/magazine/content/01\\_26/b3738001.htm](http://www.businessweek.com/magazine/content/01_26/b3738001.htm)

of Jacques Nasser in October 2001, faces the monumental task of reviving the world famous carmaker from the brink of death. William Clay Ford Jr., also called Bill Ford, believes that the company lost focus in several areas and launched the ‘back to basics’ campaign through out the company. He wants to make the ‘blue oval’ shine again. He is optimistic about the company’s turnaround and says, “When people look back on 2003, I want them to remember it as a turning point.”<sup>7</sup>

However, reality indicates that the optimism might be a bit premature. The automaker is losing money on almost every car sale. There is mounting pressure from increased competition, declining market share, poor cash situation, large unfunded pension and retiree medical liabilities and above all, a top management team that is not working together. Quality improvement programs have stalled and new product introductions are being delayed. The share price has gone down as low as \$6.60 in March 2003, far lower than when Bill Ford became president about 18 months ago.<sup>8</sup> If the company were a vehicle riding over as many potholes as it, the vehicle would have broken down long ago. The company slipped from a zenith to a nadir in just a span of three years. A poorly led ambitious transformation, loss of focus on the core business operations, poor product quality, loss of employee morale are some of the key factors the led to loss of Ford’s dominance in the automobile market.

### **Background - Automobile industry in the United States**

In the United States, the automotive industry is a highly competitive cyclical business. The number of cars and trucks sold to retail buyers or ‘industry demand’ varies substantially from

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<sup>7</sup> Kerwin, K. 2003. Can Ford pull out of its skid? *BusinessWeek online*, March 31, [http://www.businessweek.com/magazine/content/03\\_13/b3826055\\_mz017.htm](http://www.businessweek.com/magazine/content/03_13/b3826055_mz017.htm)

<sup>8</sup> Kerwin, K. 2003. Can Ford pull out of its skid? *BusinessWeek online*, March 31, [http://www.businessweek.com/magazine/content/03\\_13/b3826055\\_mz017.htm](http://www.businessweek.com/magazine/content/03_13/b3826055_mz017.htm)

year to year depending on “general economic conditions, the cost of purchasing and operating cars and trucks, the availability of credit and fuel.”<sup>9</sup> Cars and trucks being durable items, consumers can wait to replace them and the reduced industry demand reflects this factor. The industry in the US is characterized by a capability to overproduce as many as 20 million cars.<sup>10</sup> Also, competition in the US has intensified in the last few decades with Japanese carmakers i.e., Toyota and Honda gaining a foothold in the US market. To counter the problem of foreignness, these companies have set up production facilities in the US and have gained acceptance of the American consumers. Product quality and lean production are major competitive weapons with which the Japanese carmakers are supposed to be gaining over the American carmakers (Appendix 1). Additionally, the increasing concern for environment is making companies explore newer hybrid technologies to produce more environment friendly cars.

Cost pressures, cut-throat pricing and over capacity have heralded a phase of consolidation in the industry. The merger between Daimler Benz and Chrysler Corporation in 1998 sparked off this phenomenon. According to industry experts, the 40 players in the automobile industry are expected to collapse to 6 in the span of a decade. Each company should have over 5 million plus in sales volume just to remain profitable.<sup>11</sup> Yet, in 1999, only two companies, General Motors and Ford, qualified for that mark with other companies closely running to reach that level. Faced with increased competition and very fast changing customer preferences, innovative product designs have become more critical than ever in the industry. Highly competitive consumer financing offers in an attempt to retain or gain market share are squeezing the profit margins of

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<sup>9</sup> SEC filings. <http://www.sec.gov/Archives/edgar/data/37996/000003799603000013/0000037996-03-000013.txt>

<sup>10</sup> Naughton, K., Miller, K.L., Muller, J., Thornton, E. & Edmondson, G. 1999. Autos: The Global Six. *BusinessWeek Online*, Jan 25, [http://www.businessweek.com/1999/99\\_04/b3613010.htm](http://www.businessweek.com/1999/99_04/b3613010.htm).

<sup>11</sup> Naughton, K., Miller, K.L., Muller, J., Thornton, E. & Edmondson, G. 1999. Autos: The Global Six. *BusinessWeek Online*, Jan 25, [http://www.businessweek.com/1999/99\\_04/b3613010.htm](http://www.businessweek.com/1999/99_04/b3613010.htm)

even the major players and the American companies are facing a situation of growth without profitability. However, the Japanese carmakers are able to offer a better value than the American carmakers in this regard with their improved product designs and quality.<sup>12</sup> The troubles in the automotive industry have been accentuated with the 9/11 attack on the World Trade Center and the recession in the economy pushing the already stressed automakers to the edge.

While there is a glut in the US automobile market, the markets in Asia, Central and Southern America, Central and Eastern Europe are all showing an increasing promise for new cars and the automobile industry is entering into an era of 'global motorization.'<sup>13</sup> To address this opportunity for expansion, companies have to gear up to meet the tastes and preferences of customers around the world if they wish to secure market dominance.

### **Ford Motor Company- A profile**

Ford Motor Company was started by Henry Ford in 1903 to produce and sell automobiles designed and engineered by him. This company was acquired by another Michigan company by the same name and incorporated as the Ford Motor Company in Delaware in 1919 and went public in 1956.<sup>14</sup> The Ford family still retains 40 percent of voting shares in the Ford Motor Company. Ford was the company to have founded the first modern auto assembly line. Its Model T brought the car within the reach of the masses.<sup>15</sup> However, Ford lost its leadership

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<sup>12</sup> Muller. J., Kerwin. K., Welch. D., Moore P. L. & Brady D. 2001. Ford: Why it's worse than you think? *BusinessWeek Online*, June 25, [http://www.businessweek.com/magazine/content/01\\_26/b3738001.htm](http://www.businessweek.com/magazine/content/01_26/b3738001.htm); Hakim. D. 2002. All that easy credit haunts Detroit now. *The New York Times*, January 6; Hakim. D. 2003. Long Road Ahead for Ford. *The New York Times*, March 14.

<sup>13</sup> Okuda, H. Chairman's messages, August 2002, [http://www.toyota.co.jp/IRweb/invest\\_rel/top\\_message/chairmans/index2.html](http://www.toyota.co.jp/IRweb/invest_rel/top_message/chairmans/index2.html)

<sup>14</sup> SEC filings of Ford Motor Company, 2002. <http://www.sec.gov/Archives/edgar/data/37996/000003799603000013/0000037996-03-000013.txt>

<sup>15</sup> <http://www.ford.com/en/heritage/history/default.htm>



position to General Motors soon after the Model T because the company was not able to address the market need for vehicles that were other than “black.”

The two core businesses of the Ford company are their automotive and financial services. The automotive sector comprises the design, development, manufacture, sale and services of cars and trucks. The financial services sector operations is comprised of Ford Motor Credit Company, a wholly owned subsidiary of Ford, and The Hertz Corporation-an indirect, wholly owned subsidiary of Ford. Ford Credit provides leasing, insurance and vehicle-related financing. Hertz rents cars, light trucks and industrial and construction equipment.<sup>16</sup> Ford is the world’s largest producer of trucks. It is the second largest producer of cars and trucks in the United States after General Motors<sup>17</sup> (Appendix 2<sup>18</sup>).

Ford has production facilities around the world on six continents and sells its products worldwide. The majority of sales come from the US market as it is for all other major carmakers (See Appendix 4). Ford has extremely strong brand recognition, strong financial and marketing network and was known for its innovative products (Appendix 3). Its products enjoyed great demand. About one million of the Mustang model was built in the first two years of the introduction of the model. The Ford Escort model made a record as the ‘fastest first million units for a new car’ and its original Model T was named as the car of the century in 1999.<sup>19</sup> Ford had about \$5.9 billion in net income from continuing operations in the year 1998 making it the world’s most profitable automaker. Ford’s Taurus, Explorer and other brands are extremely popular and Ford managed to gain a strong hold in the SUVs and pickup truck markets, the

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<sup>16</sup> Company profile from yahoo finance. <http://biz.yahoo.com/p/f/f.html>

<sup>17</sup> General Motors press release. Nov 16, 2000. [http://media.gm.com/news/releases/corp\\_infrastructure\\_111600.html](http://media.gm.com/news/releases/corp_infrastructure_111600.html)

<sup>18</sup> <http://www.ford.com/en/company/about/corporateCitizenship/principlesProgressPerformance/our-performance/fin-health-data.htm>

<sup>19</sup> Ford Motor Company website. <http://www.fordmotorcompany.co.za/corporate/history/ford.asp>

profitability of which has now attracted many other automakers to vie for this segment. Ford has been among the Best Managed companies in the world. Ford's stock price rose by 130 percent since 1996 and by 1999 it was far ahead of the 71 percent gain of the Standard and Poor's (S&P) 500 stock price index and its global auto rivals.<sup>20</sup> Ford had about \$23 billion in cash reserve and was eager to oust GM from its leadership position. There were predictions that Ford would soon achieve its objective.

### **Jacques Nasser and the remaking (breaking?) of Ford<sup>21</sup>**

In September 1998, with the retirement of Alex Trotman, Jacques Nasser was named the president and CEO of Ford Motor Company effective Jan. 1, 1999. William Clay Ford Jr., was named the non-executive chairman.<sup>22</sup>

Nasser worked with Ford for nearly 31 years before reaching the top position in the company. Born in Lebanon and brought up in Australia, Nasser had a degree in international business but was known for his astuteness in finance, management and in making great cars that people wanted. He was the man of choice for turning around troubled divisions in Philippines in 1977, returning to Australia again in 1990 from where he moved to turnaround the European operations. He has been at the headquarters since 1994 when he was appointed the head product development.<sup>23</sup>

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<sup>20</sup> Kerwin, K & Naughton, K. 1999. Remaking Ford. *BusinessWeek*. October 11: 132-136. [http://www.businessweek.com/magazine/content/01\\_25/b3737047.htm](http://www.businessweek.com/magazine/content/01_25/b3737047.htm)

<sup>21</sup> Kerwin, K & Naughton, K. 1999. Remaking Ford. *BusinessWeek*. October 11: 132-136 [http://www.businessweek.com/1999/99\\_41/b3650001.htm](http://www.businessweek.com/1999/99_41/b3650001.htm)

<sup>22</sup> From cash cushion to cash crunch.

<http://interactive.wsj.com/archive/retrieve.cgi?id=SB1010529442377175840.djm>

<sup>23</sup> Kerwin, K & Naughton, K. 1999. Remaking Ford. *BusinessWeek*. October 11: 132-136. [http://www.businessweek.com/magazine/content/01\\_25/b3737047.htm](http://www.businessweek.com/magazine/content/01_25/b3737047.htm)

Nasser was known for his ‘impatient, highly entrepreneurial and ‘can-do’ mentality -- a distinctly American characteristic.’<sup>24</sup> As chief of global auto operations in 1996, when Ford had its worst profits from vehicle sales as compared to other US automakers, Nasser made far reaching changes, pruned the car models and cut jobs and squeezed suppliers for a cumulative \$6.2 billion in savings. Such actions earned him the ‘Jac the Knife’ nickname. He did more than just cutting costs however. It was Nasser who drove the creative designs at Ford that made the company seize the lead into the red-hot markets of pickups and SUVs. Nasser seemed to thrive in relatively independent operations. According to Robert A. Lutz, ex-Chrysler vice-chairman who was once Nasser’s boss, “Jac learned to make decisions in smaller markets where you could make fast decisions without a lot of bureaucratic oversight from Dearborn.” Also, according to some former employees, Nasser had too aggressive a style that alienated him from others but he was supposed to have mellowed down as he moved up the ladder. However, Nasser was truly committed to make people get excited about buying Fords again. He was the heir-apparent to CEO Alex Trotman right from the time he was President of Ford automotive operations.

With several years of experience at Ford, Nasser knew Ford’s bureaucratic culture and was impatient to change it. Decisions would be made at snail’s pace and managers guarded their bureaucratic fiefdoms more than the interest of the company. Nasser was impatient to change it all.

Nasser’s envisioned to reinvent Ford as a “nimble, growth-oriented consumer powerhouse for the 21<sup>st</sup> century” when only a few giant auto companies would battle across the globe. He wanted “Ford to be not only the world’s top carmaker, but also among the top companies,

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<sup>24</sup> Zesiger. S. 1998. Jac Nasser is car crazy. *Business2.0*, June Issue. <http://www.business2.com/archives/0,,00.html>

period.”<sup>25</sup> He set General Electric as a model for his company and Jack Welch as a role model for himself.

Shortly after Nasser took over as the CEO, he declared war on the rigid bureaucratic culture at Ford<sup>26</sup>. Under Alex Trotman’s Ford-2000 initiative, several activities such as purchasing, engineering and manufacturing were centralized globally, mainly for cost efficiencies. But regional managers started feeling that they lost say on the products. Nasser drew up a plan to pull down this global monolithic structure, to give the regional managers more power to shape local brands and marketing. His vision was of a company where executives ran their independent units without too much bureaucracy and they would be held responsible for their successes and failures. Nasser’s highest priority was to revamp how Ford designed its vehicles. He did away with the longtime practice of updating aging models to match those of top competitors. He ended Ford’s over dependence on quantitative analysis and ‘focus groups’ and shifted it to knowing customers more closely.

Customer focus was to be at the heart of the new Ford in which designers, engineers and marketers were to do a far better job of anticipating the customer wants and needs. Not only did Nasser plan to give back more power, but he also devised programs to get his executives in close touch with customers. Executives would attend a daylong program at the ‘Customer Insight Center’ to learn how to listen to their customers. Small teams would then be sent out for eight weeks of “customer immersion” in which the members eat, shop, dine, dance with the customer groups to know them better and get an intuitive feel of what the customers wanted. All such initiatives were aimed at improving the design capabilities by knowing customers better.

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<sup>25</sup> Muller, J. 2001. Commentary: Ford: Jacques Nasser Can’t Do It All. *BusinessWeek Online*. June 18. [http://www.businessweek.com/magazine/content/01\\_25/b3737047.htm](http://www.businessweek.com/magazine/content/01_25/b3737047.htm)

<sup>26</sup> This section draws heavily from the ‘Remaking Ford’ article already cited.

Nasser was obsessed to make his company the leader. In order to boost up the profit margins and also to unseat GM from its leadership position, Nasser decided to expand Ford's operations of luxury car business through acquisitions. Ford bought Volvo for \$6.47 billion in 1999, Land Rover from BMW in 2000, and expanded their Jaguar division. All these luxury brands were to be managed by the Premier Automotive Group (PAG). PAG was expected to contribute to one-third of global profits by 2005. Resources were spent on Mazda Motor Corp and Lincoln units to restore these ailing units to good health. In order to make the luxury brand portfolio a success, Nasser hired Wolfgang Reitzle, the No.2 executive from BMW. Reitzle had a well-earned reputation from improving BMW's market position in 1990s. He was to take control of Ford's four luxury brands: Jaguar, Volvo, Lincoln and Aston Martin. Nasser brought in top management talent into Ford from wherever the best talent could be found. James C Schroer, a former RJR Nabisco marketing chief and later a Booz, Allen & Hamilton consultant was brought in as Ford's global marketing vice-president in-charge of building up Ford's brands, especially the weaker Mercury and Ford brands. Next in October 1997, he tapped J. J. Mays, who sketched the stunning design that became Volkswagen's new Beetle. Chris Theodore, an engineer known for work that helped Chrysler's minivans become a hit, came on board to run large-and luxury-car development. This new management team was expected to capture the secret of success of Ford's truck business and make the same work in the car business.

To increase profits further, Nasser pushed to spin off Ford's low-margin parts operation, Visteon Automotive Systems, in mid 2000, as he marched into higher-margin services. He wanted Ford to deal with everything connected with a car and not just sales. He figured out that while a customer spends about \$20,000 for purchasing a car, over its life, a car generates another \$48,000 in revenues when maintenance, spare parts, gas, and insurance are included. Ford was

now to get into all things such as retailing, distribution, auto repair and services, driving school, car-rental agencies (Hertz corporation) and even junkyard recycling. “Running a junkyard can provide valuable information about parts durability and reliability,” said Micheal D. Jordan, Vice-president of Ford’s customer service. This was supposed to be the ‘cradle-to-grave’ strategy. While there were criticisms to his approach, Nasser did seem to enjoy the support of Bill Ford. Bill Ford said that the board approved Nasser’s strategy as it did not digress too far from the core business as was the case with Ford’s earlier efforts at diversification into banking and other non-auto businesses in the 80s.

As part of this strategy, Ford paid about \$1.6 billion to acquire the ‘Kwik-Fit’, a chain of nearly 20,000 auto service centers in Britain. On the retail front, Ford began buying dealerships in selected US markets. The majority stake in the groups was then sold back to the dealers who formerly owned the stores. One dealer was chosen to run each dealership group with considerable input from Ford. The idea was to learn more about the retail business and bring new efficiencies to the process of selling cars and trucks. Nasser wanted to protect Ford’s distribution network base by not having too many dealerships purchased by big retail chains such as the AutoNation Inc<sup>27</sup>.

Further, in a move to take advantage of the Internet, Nasser struck innovative deals with Microsoft CarPoint and Yahoo. CarPoint was to launch the “build to order” service through which customers could tell Ford exactly what features and colors they wanted in their cars. Although traditional dealers would fulfill the orders, CarPoint was to sell the aggregated customer data to Ford. In Nasser’s opinion, this data was invaluable as it directly reflected what

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<sup>27</sup> Box. T. 2002. Ford sells last of retail network. *DallasNews.com-The Dallas Morning News*, April 5. [http://www.dallasnews.com/cgi-bin/gold\\_print.cgi](http://www.dallasnews.com/cgi-bin/gold_print.cgi)

the customers', especially younger ones, wanted. Also, in order to drive the IT revolution into every nook-and-cranny of the company, Nasser got every employee in Ford a computer and Internet connection so that each could be as close as possible to the customer in real time.<sup>28</sup>

On the personnel front, Nasser launched a new performance review ranking system to improve employee performance and productivity. This system of performance review required the managers to rank employees against others on a curve. According to this system, of the 18,000 managers at Ford, up to 10 percent received an "A" grade, 85 percent could receive a "B", and 5 percent (initially supposed to be 10 percent, with adjustments to the other figures) could receive a "C" grade. Those who got a "C" grade for two consecutive times were subject to demotion or termination.<sup>29</sup> This system was supposed to promote competitive and winning performance in which no executive had any entitlement and everything was to be earned.

Things was looking good till the middle of year 1999 when Ford became the world's most profitable automaker with about \$7.2 billion in net income.<sup>30</sup> With its purchase of Volvo and increased control of Mazda, Ford was looking all set to overtake GM by year 2001.

### **The Fatal Skid**

Nasser had very high ambitions and initiated too many changes in the 96-year-old system, perhaps too quickly for it to adapt. Most of the initiatives backfired. There were also deeper

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<sup>28</sup> McCombie. H. 2000. Interviews: Jac Nasser, CEO & President Ford Motor Company. *Business Sunday*, March 12. [http://businessunday.ninemsn.com.au/businessunday/Interviews/stories/story\\_1131.asp](http://businessunday.ninemsn.com.au/businessunday/Interviews/stories/story_1131.asp)

<sup>29</sup> Labor and Employment Law Update, June 2002. The Lessons of Ford's Forced Ranking Performance Review System. <http://www.shpclaw.com/updates/lessonsford.html>

<sup>30</sup> Muller. J., Kerwin. K., Welch. D., Moore P. L. & Brady D. 2001. Ford: Why it's worse than you think? *BusinessWeek Online*, June 25, [http://www.businessweek.com/magazine/content/01\\_26/b3738001.htm](http://www.businessweek.com/magazine/content/01_26/b3738001.htm); Jackson. M. 2002. The Leaders Who Run Toward Crises. *The New York times*, December 22. <http://www.nytimes.com/2002/12.../22EXLI.html?ntemail=&pagewanted=print&position=to>

systemic problems that grew over the long years of the company's existence underling many of Ford's problems. Added to these were external factors such as the crisis with Firestone over problems with tires and the economic downturn that led to his and the company's debacle.

The pace of change introduced by Nasser upset many longtime Ford employees. Managers were grumbling about a burnout in an organization with new initiatives flooding-in one after the other. "Nasser is grabbing people by the throat and threatening their careers," said one of the employees. Many employees said, "If I can get through this boot camp, I'll survive." But the boot camps just kept coming.<sup>31</sup> The new performance review ranking system led to a loss of employee morale and loss of several talented people from the organization. The culminating event was the launch of a class action suit in February 2001 by frustrated employees claiming that the system discriminated against older employees.<sup>32</sup>

On the market front, while large profits from cars and trucks were being ploughed into the PAG acquisitions to boost up the luxury car business, little attention was paid to the development of mass market cars and trucks where Ford was making its money. Competition took advantage of this factor. General Motor Corporation's Silverado and Sierra pick-ups, for instance, overtook Ford Division's top-selling F-series in 2001. New pickups launched by Toyota and Dodge also cut into F-series sales and profits<sup>33</sup>.

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<sup>31</sup> Kerwin, K & Naughton, K. 1999. Remaking Ford. *BusinessWeek*. October 11: 132-136.  
[http://www.businessweek.com/magazine/content/01\\_25/b3737047.htm](http://www.businessweek.com/magazine/content/01_25/b3737047.htm)

<sup>32</sup> Labor and Employment Law Update, June 2002. The Lessons of Ford's Forced Ranking Performance Review System. <http://www.shpclaw.com/updates/lessonsford.html>, Shirouzu, N. 2001. Nine Ford workers file bias suit saying ratings curb older staff. *The Wall Street Journal*. February 15.  
<http://interactive.wsj.com/archive/retrieve.cig?id=SB982192206169872684.djm>

<sup>33</sup> Kerwin, K. 2002. Where are Ford's hot cars? *BusinessWeek Online*. June 24.  
[http://www.businessweek.com/magazine/content/02\\_25/b3788084.htm](http://www.businessweek.com/magazine/content/02_25/b3788084.htm)



Dealers were not happy with Ford's entry into retailing. They hated the concept of Ford's purchasing dealerships and selling them back. Dealers had millions invested in their stores and were dependent on Ford for inventory and for financing. Dealers outside the network were apprehensive that the factory-owned stores would get better treatment than the dealer owned stores resulting in sour relationships. In 2001, Nasser had to disband the retail network in an attempt to mend relationships with dealers. Many dealers believed that the push for ending the retailing experiment might have come from the then chairman, Bill Ford.<sup>34</sup>

On the manufacturing front, production and quality problems grew. Ford had troubled launches for even those cars it could not afford to miss. Ford's Escape sport utility went on sale in the summer of 2000 amid favorable reviews and five recalls. Even the Thunderbird model was repeatedly delayed. Production problems caused the assembly line to halt twice leading to poor deliveries to dealers and missed opportunities.<sup>35</sup>

Nothing could have contributed to the downfall of Jacques Nasser more than the Firestone/Bridgestone controversy. The problem with Firestone tires on Ford Explorer was not a new one. Perhaps, it was Nasser's bad luck that the problem erupted and blew out during his tenure. Sport utility vehicles are prone to roll over and crash and there was a suspicion that the Firestone's wilderness AT tires lead to an increased accident rate. The problem was higher with Ford Explorer on which the tires were original equipment and this was known to happen since the 80s. Due to higher number of accidents and deaths, a formal National Highway Transportation and Safety Administration (NHTSA) investigation was launched in May 2000.

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<sup>34</sup> Box, T. 2002. Ford sells last of retail network. *DallasNews.com-The Dallas Morning News*, April 5. [http://www.dallasnews.com/cgi-bin/gold\\_print.cgi](http://www.dallasnews.com/cgi-bin/gold_print.cgi)

<sup>35</sup> Maynard, M. 2002. Even cars need to make a good first impression. *The New York Times on the web*. March 8. <http://www.nytimes.com/2002/03/08/automobiles/08CARS.html?pagewanted=print&posi...>

Both companies responded to this issue by blaming each other. John Lampe, the CEO of Firestone, argued that the same type of tire performed well on Toyota and General Motors SUVs while there were greater problems with the tire on Ford Explorer. Therefore, according to him, the problem was with the design of Ford Explorer rather than with Wilderness tires.<sup>36</sup>

In any case, keeping customer safety and satisfaction in view, Ford & Firestone issued a massive recall of 14 million tires in August 2000. Nasser wanted to do something to address customer concerns regarding safety of Ford vehicles. In May 2001, he issued a recall for all Ford Explorers and other vehicles with Firestone tires on them. This move was to cost the company over \$3 billion,<sup>37</sup> one of the biggest recalls ever in the automobile industry. This was the flash point that marked not only the end of nearly a century old relationship between Firestone and Ford but also Nasser's end as the CEO of the company. There was so much of mudslinging between the companies it led to the loss of customer trust due to poor handling of this issue. There seemed to be no end to quality problems, deteriorating employee morale and the bad publicity due to the Firestone Fiasco. Added to this, was the growing divide between Bill Ford and Jacques Nasser with Bill Ford feeling that Nasser was cutting off his communication with top executives. The problems for Nasser were exacerbated by the downturn in the industry after the September 11, 2001 World Trade Center Attack and with his losing the support of senior management. Nasser was replaced in October 2001 by Bill Ford as the Chief Executive. The Ford company posted a \$500 million loss in October 2001 for its preceding quarter, the first time that Ford was in the red in two successive quarters after 1992 recession.<sup>38</sup> Ford incurred a loss of \$5.5 billion in the year

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<sup>36</sup>Ackman. D. 2001. Ford, Firestone on the hill. *Forbes*, June 19. <http://www.forbes.com/2001/06/19/0619tires.html>

<sup>37</sup>Recalled Tire—Firestone and Ford, <http://www.recalledproduct.com/recalledtire/>

<sup>38</sup>Treanor. J. & Gow. D. 2001. Ford ploughs deeper into red. *The Guardian*, October 18. <http://www.guardian.co.uk/Print/0,3858,4279588,00.html>, Glover. M. 2001. Analysis: Nasser lost clan's confidence as PR disasters kept growing. [http://classic.sacbee.com/ib/news/old/ib\\_news03\\_20011031.html](http://classic.sacbee.com/ib/news/old/ib_news03_20011031.html), October 31.

2001<sup>39</sup> (Appendix 4). Ford's market share and quality ratings sank and Standard & Poor's lowered its credit rating<sup>40</sup>.

Industry sources opined that Nasser was so busy leading Ford headlong into the future that he has not could not spend time on the basics of running a \$170 billion auto company. "I think Ford management is really stretched," said a source close to Ford's senior management. "There are just too many initiatives going on. Now they're paying the price for taking their eye off the ball." No one was more overextended than Nasser himself. He had 16 direct reports at one point and he was so busy that he could not find a successor to himself as head of worldwide automotive operations since he became the CEO, also there was no chief operating officer.<sup>41</sup> Some others feel that Nasser could not communicate his vision and garner support for the transformation efforts. Scott Hill, an auto analyst with Sanford Bernstein said, "Nasser's been the primary architect of a failed transformation of Ford from its core automotive heritage to some expansive consumer-centric organization, which we think employees, dealers, supplier and investors have found to varying degrees to be somewhat incomprehensible."<sup>42</sup>

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<sup>39</sup> Teather. D. 2002. Ford's losses climb to \$5.5 bn for year. *The Guardian*, January 18.

<http://www.guardian.co.uk/Print/0,3858,4337912,00.html>

<sup>40</sup> Treanor. J. & Gow. D. 2001. Ford ploughs deeper into red. *The Guardian*, October 18.

<http://www.guardian.co.uk/Print/0,3858,4279588,00.html>

<sup>41</sup> Muller. J. 2001. Commentary: Ford: Jacques Nasser Can't Do It All. *BusinessWeek Online*. June 18.

[http://www.businessweek.com/magazine/content/01\\_25/b3737047.htm](http://www.businessweek.com/magazine/content/01_25/b3737047.htm)

<sup>42</sup> Isidore. C. 2001. Nasser out as Ford CEO. *CNNmoney*, October 30. <http://money.cnn.com/2001/10/30/ceos/ford/>

## The new CEO and a new era at Ford<sup>43</sup>

William Clay Ford Jr., (Bill Ford), replaced Nasser as the chief executive officer of Ford Motor company in October 2001. Along with him was brought in a new management team. Nick Scheele, the group vice-president of North America became the chief operating officer. James Padilla, group vice president for manufacturing and quality succeeded Nick Scheele as group vice-president North America. Carl Reichardt, a longtime board member and retired CEO and chairman of Wells Fargo & Co. became the vice-chairman of the board and was to take an active role overseeing financial operations, including that of Ford credit. Several other seniors who left Ford during Nasser's term on premature retirements are being brought back.

Bill Ford, as CEO, is not as experienced as his colleagues at the other big automobile companies. Even Nick Scheele and James Padilla do not have experience of handling jobs of such scale. However, Bill Ford is known to have a 'non-traditional personality' for a CEO. He is known for his strong views regarding environment protection that gave him 'tree hugger' label. According to many sources, he has a relatively 'pro-employee, even pro-union reputation'. He is very popular among the blue-collar and white-collar employees who distrusted Nasser. The workers gave him an enthusiastic response on October 30, 2001 when he became the CEO. Ford views building relationships as his key job going forward. "You can't build the business if you don't have strong partnerships," Ford said. "Dealers, United Autoworkers Union, white collar

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<sup>43</sup> This discussion draws heavily from the following sources: Isidore. C. 2001. Nasser out as Ford CEO. *CNNmoney*, October 30. <http://money.cnn.com/2001/10/30/ceos/ford/>, Taylor III. A. 2003. Getting Ford in Gear. *Fortune*, April 28. <http://www.fortune.com/fortune/print/0,15935,446373,00.html?>, Teather. D. 2002. Ford's losses climb to \$5.5 bn for year. *The Guardian*, January 18. <http://www.guardian.co.uk/Print/0,3858,4337912,00.html>, Kerwin. K. 2002. Where are Ford's hot cars? *BusinessWeek Online*. June 24. [http://www.businessweek.com/magazine/content/02\\_25/b3788084.htm](http://www.businessweek.com/magazine/content/02_25/b3788084.htm), Shirouzu. N., White. G. L., & White J. B. 2002. Ford's Retrenchment Seeks to Cut Costs And Make Its Factories More Flexible. *The Wall Street Journal* (Page One Feature), January 14. <http://interactive.wsj.com/archive/retrieve.cig?id=SB1010758959555716440.djm>

employees, suppliers, Wall Street—we have a lot of relationships that are important to us. A lot of those are broken and not healthy,” he said.

According to some sources, Bill Ford is the right person to lead Ford at this juncture. The Ford name gives him the credibility and employee support crucial for the success of any change efforts. He considers bringing back focus in operations as critical to success. “We won’t hesitate to pull the trigger if something isn’t fitting in well,” said Ford. “I think we have lost the focus in a couple of areas.” Consistent with these beliefs, Ford and his team outlined a ‘back to basics’ approach for the company in which the focus of the company was to be on ‘designing, building and selling the industry’s best cars and trucks—and restoring the company’s profitability’. He wants a ‘product-led renaissance.’ As part of this strategy, in January 2002, a sweeping restructuring plan that included closure of three assembly plants in North America, closure of two plants making auto parts, employee layoffs, sale of non-core assets including the Kwik-Fit retail chain was announced. The company also planned to reduce production by over 1 million cars keeping in view the chronic overcapacity in the industry. He also unveiled plans to cut off every bit of wasteful expenditure.

Another area that received particular attention was Ford Credit. The expansion of Ford Credit which generated more profit margins than the core auto business has not proved beneficial in the changed times. With shrinking market share of Ford, expansion of Ford Credit meant lending to not just for Ford’s own vehicles but also for other brands and sometimes for customers with less than admirable credit history. Even risky borrowers were charged too-low interest rates in its ambition to become “global auto-finance superpower.” The strategy did not work well in a soft

economy where default rates increased. The company finally abandoned this ambition in January 2002 and decided to concentrate on lending for its own vehicles.

In the meantime, in January 2002, Ford wrote-off \$1 billion on its palladium stockpile which was shocking news on the Wall Street. Palladium is used in catalytic converters to make the emissions from automobiles cleaner. At Ford, while the R&D department, on the one hand, was discovering ways to reduce the need for palladium, the other hand, purchasing, was stockpiling the precious metal due to erratic market conditions. With a change in the demand /supply situation and also due to the breakthroughs in technology, the massive stockpile had to be written off. While GM and other companies successfully hedged their risks on purchase of precious metals, the lack of communication between the purchase and treasury department (they routinely did ‘hedging’) led to this huge loss.<sup>44</sup> There was virtually no communication between purchasing, research and the finance departments reflecting the deep-rooted problems in the massive organization.

As a result of the transformation efforts of Bill Ford, in October 2002, the company announced that though it had a net loss of \$326 million in the third quarter of the year, it earned an operating profit of \$220 million. The company had cut its cost per vehicle by \$240 and trimmed \$2 billion from overhead and raised \$1 billion from sale of assets. The company is credited with having 3 to 4 of the top 10 selling vehicles in America in the last 10 years and it has a history of great

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<sup>44</sup> White. G. L. 2002. A Mismanaged Palladium Stockpile Was Catalyst for Ford’s Write-off. *The Wall Street Journal*, February 6.  
<http://www2.uta.edu/hyland/Derivative%20News%20Stories/ford's%20palladium%20problem.html>

resilience in surviving crisis situations. However, Wall Street was not very convinced, and while stocks traded at \$7.15 a share<sup>45</sup>, S&P downgraded Ford's ratings further to BBB - in 2002.<sup>46</sup>

### **The challenges**

The situation did not change much by April 2003 (Appendix 5). Ford's problems persist. Weak sales and rising inventories forced Ford to slash second-quarter production for 2003 by 17 percent from Spring 2002. Ford is struggling to retain its 21 percent market share<sup>47</sup> (Appendix 6). The PAG had engineering in Sweden, England and Michigan and marketing in California and was unmanageable from its start. PAG lost \$88 million in the first quarter of 2003. Additionally, while grand plans were being made for each brand, the business shrunk. Lincoln lost \$1 billion in 2001, Jaguar lost \$500 million in 2002, and Land Rover turned profitable only recently. Lincoln's expansion plans have been scaled down<sup>48</sup>; PAG shifted the focus away from mass markets in which rivals have taken advantage and Ford struggles to get a "hit" mass-market car out to regain its position.

While Nasser's tenure was certainly responsible for some major problems of Ford today, there are much deeper systemic issues to be dealt with. The four major areas where Ford needs to

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<sup>45</sup> Morris, B. 2002. Can Ford Save Ford? *Fortune*, November 18.

<http://www.fortune.com/fortune/ceo/articles/0,15114,390071,00.html>

<sup>46</sup> Kerwin, K. 2003. Can Ford pull out of its skid? *BusinessWeek* online, March 31,

[http://www.businessweek.com/magazine/content/03\\_13/b3826055\\_mz017.htm](http://www.businessweek.com/magazine/content/03_13/b3826055_mz017.htm)

<sup>47</sup> Kerwin, K. 2003. Can Ford pull out of its skid? *BusinessWeek* online, March 31,

[http://www.businessweek.com/magazine/content/03\\_13/b3826055\\_mz017.htm](http://www.businessweek.com/magazine/content/03_13/b3826055_mz017.htm)

<sup>48</sup> Taylor III, A. 2003. Getting Ford in Gear. *Fortune*, April 28.

<http://www.fortune.com/fortune/print/0,15935,446373,00.html?>

concentrate and improve to be able to survive are product development, manufacturing systems, finance and management<sup>49</sup>.

Product development at Ford has become too complex over years. Vehicle design has become too expensive because of overlaps that are caused by the ‘Internal fiefdoms’. Ford takes at least 25 percent more time to produce a vehicle design than its competitors, only to produce a “over engineered” vehicle that is too costly for the hyper-competitive US car market. In fact, as recently as April 2003, Ford’s engineering operations were built around five teams organized by vehicle types each with its own budget and technologies. The different teams often created their own unique body frames, suspension, brakes, engines and transmissions and seldom were efforts made to share these technologies<sup>50</sup>. The complexity of such a system can be gauged by the fact that there are at least 126 different types of fuel caps used in Ford vehicles in Europe alone<sup>51</sup> - a differentiation that does not create any customer value. On the contrary, the best companies in the world today thrive on sharing designs and using common platforms of basic architecture to roll out more models faster and more efficiently. Ford has just embarked on improving the process and has a long way to go.<sup>52</sup>

On the manufacturing front, Ford’s Japanese rivals and even GM are very efficient with their flexible manufacturing systems. Flexible manufacturing systems allow the production of two or

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<sup>49</sup>Shirouzu. N., White. G. L., & White J. B. 2002. Ford’s Retrenchment Seeks to Cut Costs And Make Its Factories More Flexible. *The Wall Street Journal* (Page One Feature), January 14.

<http://interactive.wsj.com/archive/retrieve.cig?id=SB1010758959555716440.djm>

<sup>50</sup> Shirouzu. N. 2003. Ford’s New Development Plan: Stop Reinventing Its Wheels. *The Wall Street Journal*, April 16.

<sup>51</sup>Morris. B. 2002. Can Ford Save Ford? *Fortune*, November 18.

<http://www.fortune.com/fortune/ceo/articles/0,15114,390071,00.html>

<sup>52</sup>Shirouzu. N., White. G. L., & White J. B. 2002. Ford’s Retrenchment Seeks to Cut Costs And Make Its Factories More Flexible. *The Wall Street Journal* (Page One Feature), January 14.

<http://interactive.wsj.com/archive/retrieve.cig?id=SB1010758959555716440.djm>



three different sizes and shapes of cars in one plant without major production halts.<sup>53</sup> It will take Ford at least a decade to catch up with them. Quality problems persist. In the April 2003 consumer reports, Ford is ranked low among big auto companies in terms of quality and reliability.<sup>54</sup> Ford's older factories are a potential reason for this poor quality. There are defects even in the new models. Ford spends way too much on financing options for its customers than competing with better models and quality. This will only lead the company to spend way too much to get too little return<sup>55</sup>.

The balance sheet, with huge retiree obligations and massive debt from Ford Credit is a more serious concern for Ford. With credit ratings declining, the cost of its debt is on the rise. If the industry softens further and if rivals launch another round of incentives, Ford could run into dangerously low levels of cash that can jeopardize new product launches and modernization of factories, all of which could sound a death knell to Ford's existence.<sup>56</sup>

The problem of internal fights for power continues. There is lack of communication and trust and frequent reorganizations lead to the lost of several experienced staff members. Even the new management team assembled by Bill Ford is mired with problems to the extent that the top executives need coaching by etiquette trainers to learn dealing with each other.<sup>57</sup>

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<sup>54</sup> Kerwin, K. 2003. Can Ford pull out of its skid? *BusinessWeek* online, March 31, [http://www.businessweek.com/magazine/content/03\\_13/b3826055\\_mz017.htm](http://www.businessweek.com/magazine/content/03_13/b3826055_mz017.htm); Smith. B. C. 2003. Back to Basics. *Automotive Design and Production*, <http://www.autofieldguide.com/columns/smith/1201ob.html>.

<sup>55</sup> Shirouzu. N., White. G. L., & White J. B. 2002. Ford's Retrenchment Seeks to Cut Costs And Make Its Factories More Flexible. *The Wall Street Journal* (Page One Feature), January 14. <http://interactive.wsj.com/archive/retrieve.cig?id=SB1010758959555716440.djm>

<sup>56</sup> Kerwin, K. 2003. Can Ford pull out of its skid? *BusinessWeek* online, March 31, [http://www.businessweek.com/magazine/content/03\\_13/b3826055\\_mz017.htm](http://www.businessweek.com/magazine/content/03_13/b3826055_mz017.htm); Smith. B. C. 2003. Back to Basics. *Automotive Design and Production*, <http://www.autofieldguide.com/columns/smith/1201ob.html>.

<sup>57</sup> Taylor III. A. 2003. Getting Ford in Gear. *Fortune*, April 28. <http://www.fortune.com/fortune/print/0,15935,446373,00.html?>

Bill Ford has major challenges ahead in reviving his company. The company has gone through leadership changes and failed transformation efforts over the last 5 years and is struggling in the turbulent environment for survival. Bringing back the focus to creating customer value, building distinctive competencies and creating a culture committed to excellence seem to be the only ways to pull Ford off this skid. Will Ford be able to regain its dominance? Or will it die?

**Discussion questions:**

- 1. What are the causes for the loss of Ford’s dominance in the automobile market in the United States?**
- 2. What are the major challenges that need to be addressed to save Ford Motor Company? Develop a strategic intent model for Ford.**
- 3. Why did the transformation plans of Jacques Nasser fail? How could he have been successful in his efforts?**

**Appendix 1**

The production units per employee per year of lean vs. non-lean automobile manufacturers

<b>Non-Lean Companies</b>				<b>Lean Companies</b>			
<i>Year</i>	<i>GM</i>	<i>Ford</i>	<i>Renault</i>	<i>Volkswagen</i>	<i>Toyota</i>	<i>Nissan</i>	<i>Honda</i>
<b>1999</b>	13.61	9.6	12.42	25.71	23.59	17.3	19.49
<b>1998</b>	9.05	9.7	14.05	15.13	20.73	17.89	14.67
<b>1997</b>	9.15	10.33	11.65	9.99	24.59	16.07	21.02
<b>1996</b>	8.51	10.38	10.81	10.63	24.53	20.22	13.67
<b>1995</b>	7.97	15.72	10.85	8.87	22.95	15.47	16.32
<b>1994</b>	7.94	11.92	11.62	9.1	22.95	13.91	16.32
<b>1993</b>	7.55	11.71	10.8	8.3	31.29	15.54	17.24

Source: various issues of *Fortune Global 500* and *Ward's Yearbook, 1993-2000, Wards Automotive Yearbook 1993-2000*.

**Source:** Vaghefi. M. R. Creating and sustaining competitive advantage: The Toyota philosophy and its effects. <<http://www.ftmastering.com/mmo/index.htm>>, Issue 7, October 2001, and was republished in the September 5, 2002 issue of *FT.com*.

## Appendix 2

### Global Vehicle production data

Global vehicle production	2002	2001	2000		
General Motors <sup>1</sup>	8,276,000	7,786,000	8,494,000		
Ford Motor Co. <sup>2</sup>	6,973,000	7,008,000	7,424,000		
Toyota Motor Corp. <sup>3</sup>	6,309,616	5,848,094	5,888,260		
Volkswagen AG <sup>4</sup>	5,023,264	5,107,945	5,156,455		
DaimlerChrysler AG <sup>5</sup>	4,471,900	4,424,200	4,677,894		
PSA/Peugeot-Citroen SA	3,262,100	3,136,300	2,877,400		
Hyundai Motor Co. <sup>6</sup>	2,913,726	2,517,719	2,545,958		
Honda Motor Co.	2,900,787	2,651,661	2,485,213		
Sources: Ford Company	Nissan Motor Co.	2,690,295	2,466,995	2,605,155	Motor website:
	Renault SA <sup>7</sup>	2,343,954	2,375,084	2,444,370	

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[www.autonewsdatacenter.com](http://www.autonewsdatacenter.com) 2002 Market data book,

<http://kari.hmc.co.kr/indcar/G2001gpsm.pdf>

*Appendix 3*

**Ford's Brand stable**

**Vehicle brands**



**Automotive service brands**



Source: Ford Motor Company website, [www.ford.com](http://www.ford.com)

*Appendix 3a*

**The ten most significant cars from Ford**

**1901 Race car**

**Model T of 1920s**

**1940 Lincoln Continental**

**1948 F1 Pickup**

**1949 Ford**

**1955 Thunderbird**

**1965 Mustang**

**1981 Escort**

**1986 Taurus**

**1991 Explorer**

Source: Detroit free press, June 9, 2003.

[http://www.freep.com/money/autonews/cars9\\_20030609.htm](http://www.freep.com/money/autonews/cars9_20030609.htm)

**Appendix 4**

**Ford Motor Company Operating Highlights**

	<b>2002</b>	<b>2001</b>	<b>2000</b>
<b>World wide vehicle unit sales of cars and trucks in thousands</b>			
North America	4402	4292	4933
Outside NA	2571	2716	2491
Total	6973	7008	7424
<b>Sales and Revenues (billions)</b>			
Automotive	134.4	130.8	141.2
Financial services	28.2	29.9	28.8
Total	162.6	160.7	170.5
<b>Financial snapshot</b>			
Revenue	162.6	162.4	170.1
Total Net Income	-0.98	-5.5	3.5
Earnings per share	0.12	-3.02	3.8
EBITDA	25	20	35.2
Long term debt	120.1	120.8	98.9

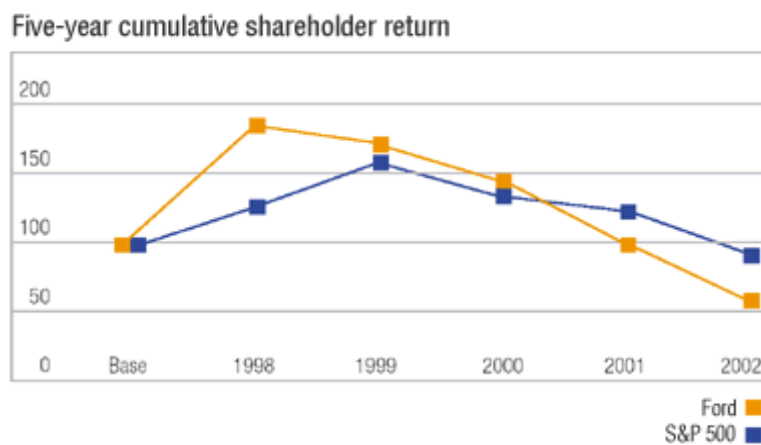
Source: Annual reports for year 2002 and 2001 from Ford Motor company website

[http://www.ford.com/en/company/investorInformation/companyFinancials/annualReports/2002annualReport/2002\\_pdfs.htm](http://www.ford.com/en/company/investorInformation/companyFinancials/annualReports/2002annualReport/2002_pdfs.htm)

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Data from Financial snapshot-company research section of Business, The New York times, taken in year 2001 and 2002.

### Appendix 5



This graph is based on an assumed \$100 initial investment, with dividends reinvested quarterly. An adjustment is made in case of Ford common stock to reflect the impact of various Ford's interests. Further, adjustments are made to show the effect of the Value Enhancement Plan of August 2, 2000 that included a merger and recapitalization.

Source: Ford Motor Company website

<http://www.ford.com/en/company/about/corporateCitizenship/principlesProgressPerformance/our-performance/fin-health-data.htm>

Appendix 6

Market share data in the US Market

<b>U.S. Car market shares</b>					
	<b>2002</b>	<b>2001</b>	<b>2000</b>	<b>1999</b>	<b>1998</b>
<b>Ford</b>	16.40%	17.70%	19.10%	19.90%	20.40%
General Motors	25.5	27	28.6	29.3	29.8
Daimler Chrysler	8.6	8.5	9.1	10.3	10.7
Toyota	12.2	11.3	11	10.2	10.6
Honda	10.3	10.7	10	9.8	10.6
Nissan	6.1	4.9	4.8	4.6	5
All other	20.9	19.9	17.4	15.9	12.9
<b>Total US car delivery</b>	100%	100%	100%	100%	100%
<b>U.S. Truck market shares</b>					
	<b>2002</b>	<b>2001</b>	<b>2000</b>	<b>1999</b>	<b>1998</b>
<b>Ford</b>	25.5	27.4	28.2	28.6	30.5
General Motors	30.7	28.9	27	27.8	27.5
Daimler Chrysler	19	19.5	21.5	22.2	23.2
Toyota	8.5	8.7	7.2	6.7	6.3
Honda	4.5	3.4	3.1	2.6	1.9
Nissan	2.8	3.2	3.7	3.2	2.7
All other	9	8.9	9.3	8.9	7.9
<b>Total Truck sales</b>	100%	100%	100%	100%	100%
<b>Combined share of US car and truck market shares</b>					
	<b>2002</b>	<b>2001</b>	<b>2000</b>	<b>1999</b>	<b>1998</b>
<b>Ford</b>	21.10%	22.80%	23.70%	24.30%	25.30%
General Motors	28.3	28	27.8	28.5	28.7
Daimler Chrysler	14.1	14.2	15.3	16.3	16.8
Toyota	10.3	10	9.1	8.5	8.5
Honda	7.3	6.9	6.6	6.2	6.3
Nissan	4.4	4.1	4.3	3.9	3.9
All other	14.5	14	13.2	12.3	10.5
<b>Total</b>	100%	100%	100%	100%	100%

Source: SEC filings, 10-k 2002.

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## **Analyzing the Time Management of Executives in Post-Soviet area (Belarus)**

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Keywords: case, Belarus, Time management

### **ABSTRACT**

This case requires students to analyze time-management and delegation issues in the context of executive managers' job content and the post-Soviet Union era's environment. Students work to find the solution to a managerial problem, prioritize the executive manager's activities, categorize tasks, choose the most appropriate method of delegation, and prepare a schedule for the executive manager's activity. Students also consider reallocating responsibilities in the top-management team, as well as the influence of political, economic, and social environments on managerial activity. This case can be used for undergraduate and graduate courses in management or leadership, as well as in international management courses.

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### DESCRIPTION OF CASE OF ALEXEY P. BORTOK AND HIS TIME

#### MANAGEMENT

This case involves a situation of overwork, stress and nervous exhaustion, which happened with the finance director (the second top position in the company). He feels that he cannot find enough time for all the activities necessary to satisfy his responsibilities.

#### *Case description*

#### INTRODUCTION

It was about 6 p.m. when Aleksey P. Bortok, finance director of Vador<sup>58</sup> Company, realized that the day was over, but he has not yet performed the majority of the duties he had planned to complete today. Half an hour ago, his wife called to remind him about a visit to her parents this evening. This visit had been planned a long time ago, so Aleksey cannot work any longer today. Aleksey realizes that he has problems related to planning and organizing his time

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<sup>58</sup> This case is based on real people and real events. However, the names of the company and all individuals have been changed in the case.

and activity. Partly this situation is a consequence of the small business environment in Belarus. At the same time Aleksey understands that difficult conditions for the business is not an excuse for poor organization of his own job as a top manager. He realizes that it is necessary to study internationally accepted best business practice and take into consideration the political, legal, economic and social environments around his company.

## SMALL BUSINESS ENVIRONMENT IN BELARUS

### *Political environment*

The political environment in Belarus is dominated by the current President Lukashenka, who has controlled Belarus since 1995. His control results in an economic model that has been described as a “command economy without central planning” (Nuti, 2000). Most productive resources are under the control of the state (Improving Business Environment, 2003).

Lukashenka’s “one-man control” results in an excessive case of micro-management. This management style is reflected in an incredible number of decrees and directives, complex systems of inspections and controls, and an attempt to put all decisions under control of President Lukashenka (Rich, 1996; Improving Business Environment, 2003).

Thus, the political environment in Belarus does not support entrepreneurial initiative or private business development. Chief executive officers (CEO’s) and entrepreneurs are pressured by a political system that seeks total control. They must run their businesses in an unfavorable political environment and adapt the usual best business practices to the constraints faced in their country.

### *Economic environment*

The economic environment in Belarus presents some difficult challenges for the development of business. Belarus, like many former Soviet countries, experienced high levels of

inflation when they established their independence from the Soviet Union. Inflation has been reduced, but other conditions still create problems.

The government's monetary decisions often complicate economic conditions. For example, inflation for the "old" Belarusian ruble was so great that in 2000 the government decided to issue a "new ruble," whose value was one thousand times that of the old ruble. It was difficult enough to change to a system in which one new ruble was worth one thousand old rubles, but this difficulty was made much more complicated when the government decided to keep both currencies circulating at the same time! Also, the government has policies controlling the amount of foreign exchange allowed within Belarus. In addition, the failure of Belarusian government policies to conform to international monetary standards means that the Belarusian ruble has no value outside Belarus.

The banking system presents unique challenges for businesses operating in Belarus. In the past, President Lukashenka swept money privately held in banks when "the country needed it." This political decision, which allowed Lukashenka to seize funds without any promise of return, resulted in a serious distrust of banks. Belarusians are afraid to deposit money in banks because of real fears that the government will take this money and not return it. Also, past experience of high inflation meant that any savings would be better kept in cash and converted immediately to euros or dollars. Obviously, these limitations on the banking industry limit traditional business practices of investment, loans for new and expanding businesses, and transfer of funds among businesses.

Government economic policies also create other difficulties for business. For example, the government controls the price business can charge for certain consumer products. However,

not all prices are controlled. A business may have to pay market prices for raw materials and then be limited to selling their final product to consumers for the government's price.

### *Social environment*

The social environment reflects conflicting values between the general Belarusian population and Belarusian business leaders. Belarusians, in general, are characterized by hospitality, decency, law-abidingness, warm-heartedness, tenderness, hard work, and compassion (Kirienko, 1999). Business leaders try to follow western values and business practices such as competition, individual initiative, and hard work. These two sets of values often conflict. The common value is hard work.

Entrepreneurs often separate themselves from traditional Belarusian values. This separation is reflected in their orientation. The average Belarusian concentrates on current problems and analyzes the past. In contrast, entrepreneurs concentrate on the future and its possibilities. This contrast results in a perception of entrepreneurs as "strange" or "alienated."

Thus, entrepreneurs are emotionally and socially isolated in Belarusian society. The gap between them and mainstream society is wide.

### *Legal environment*

The legal environment in Belarus is unstable. Its positive feature is a low level of corruption (one of the lowest when compared with other former Soviet countries such as Georgia, Armenia, and Ukraine (Improving Business Environment, 2003)). The negative feature is the concentration of power in Lukashenka and his inner circle, who assume they are above the law. Also, laws and regulations change frequently, so it is difficult for businesses to know what laws and regulations to satisfy.

The legal system in Belarus does not provide a basis for effective and efficient business activities. CEO's and business owners must create new ways to conduct business within the constraints of varying and numerous Presidential decrees.

#### VADOR LTD.

Vador Ltd. was established seven years ago, when private business was first allowed in Belarus. At the beginning Vador was a company with a proprietorship form of ownership. Its activity was devoted to wholesale foodstuff sold from Russia to Belarus and from Belarus to Russia. After three years of strong development, Vador experienced stagnation. The value of sales did not increase, and the revenue bit by bit decreased. The owner of the company Vadim found that it was a time to search for new ideas for reviving business and for inviting new creative people. After a year of crisis and changes, Vador diversified its activity, launched two new businesses, changed the form of ownership from proprietorship to partnership, built the divisional organizational structure instead of functional, and fundamentally changed the human resource management. In place of high professional employees with long experience in Soviet organizations, the young people with a new style of college education, high level of motivation, and limited experience came into the company.

Like before, the main business of the company now is food products. The business includes the following three divisions:

1. Business-to-business selling of baked goods (The supply is from Russia, but distribution is in Belarus.)
2. On-site Bakery
3. Coffee House

Delivery and Installation of baked goods and packing equipment will be the fourth business.

Three partners own the company. Aleksey owns 27 percent of the shares, his partner Vadim owns 56 percent; and a third person, who does not take part in management, owns the remaining 17 percent. There are 120 employees in the company now.

Vadim and Aleksey complement each other excellently. Vadim is a talented entrepreneur who “feels” marketing and offers creative competitive strategy. He also can create effective relationships with clients and other stakeholders. Aleksey’s strengths are his excellent analytical abilities. He focuses on analysis of a situation, identifies all the pros and cons of Vadim’s every proposal, sets up the plan for the whole company, and controls the goals’ achievement.

Vadim and Aleksey trust each other to make decisions. While one of them is out of the country, the other replaces him in all decision making.

Today is one of the times when Aleksey works for both of them. Vadim left for Austria. Then he will visit Holland for negotiations about the new business. He will be out of the country one and a half weeks.

Vadim and Aleksey have been friends for many years. Vadim called Aleksey to Vador Company from a research institute, where Aleksey was a researcher and received only enough compensation to provide a basic standard of living. Aleksey was an accountant at Vador for three years, and then he was promoted to chief accountant. Then Vadim invited him to become a shareholder to compensate him for his work and encourage him to stay, so now Aleksey shares both authority and responsibilities with Vadim. Aleksey and Vadim completely trust each other and value their respective contributions.

#### THE BASIC ISSUE

On Monday Aleksey listed all activities he had to do this week. His list included

1. Financial Analysis for the past six months (Financial indicators and ratios).



2. Weekly meeting with middle- and line-managers. The next meeting was going to be devoted to managers' proposals to improve communication inside the organization. This task had been identified at the last meeting.
3. Visiting three potential locations for their new office. The current office does not have enough space for the new business' employees. Therefore, they need a separate location for this business or a new bigger location for the whole company.
4. Appointment with Transit Bank representative. This is extremely important because of the need to discuss possible debt financing.
5. Analysis of all decisions that have been made for last the three months and determining the degree to which goals were accomplished.

Today is Thursday. Of all the planned activities, Aleksey completed only the first one.

- The "Location for the office" issue he moved to tomorrow.
- The meeting with managers has already been held, but no valuable or specific proposal was made. Therefore, discussion of the communication patterns in the organization has been rescheduled for next Monday.
- Aleksey has not started the analysis of financial data for the past three months.
- He did not make the appointment with the Transit Bank representative.

The past four days included the following activities:

#### MONDAY

- *Meeting with managers.*

This meeting lasted one and a half hours even though it had been expected to last only thirty minutes. The managers were not ready for a professional discussion of communication issues in the organization. The majority of the managers forgot to

prepare their proposals, and the rest talked about “everything and nothing”. Again, the meeting time was taken up by this problem, instead of identifying ways to solve the problem.

- *Meeting with chief-manager of the “On-site Bakery” division.*

The meeting was devoted to discussion of the possibility of opening a new delicatessen department in another location on the main street. Then discussion touched on issues such as human resource (HR) management in this division, and they considered the inefficient organizational culture. Other divisions joke that in the “On-site Bakery” division every day begins with a quarrel; and if you want to solve any problem here, you should scream, yell, or shout. It is the only usual way of conversation in this division. Aleksey spent two hours in this meeting.

- *Business meeting with one of the top clients.*

This client is a close friend of Vadim. Vadim and this client spent almost two hours discussing the down payment issue because there is a difficult situation in the client’s company. The client cannot pay ahead of time (as is the usual custom), and he has asked to pay in installments over the next few months. This arrangement would be very beneficial to the client since he would not be able to do this with other suppliers. The arrangement is, of course, risky for Vodor.

- *Again, the problem of communication flows.*

A chief-manager of the biggest division “Business-to-business selling of baked goods” is indignant about duplication of his division’s activities with the activities of other divisions. His sales person called a client for clarification of a delivery schedule. It turned out that this client purchased two Vodor products. A day before he had talked

over the same issue with the “On-site Bakery” division. This client spoke negatively of Vador management. The indignant manager met Aleksey in a corridor, and they talked 40 minutes.

- *Mail and e-mail checking took one hour*
- The remaining time was devoted to *talking by cell phone*. (Few people know this number, so Aleksey does not ignore calls he receives at this number); *daily conversation\_with employees*; etc.
- Normally, Aleksey reads the current edition of “Expert Journal” each week. However, this week he did not read the last edition of “Expert Journal”. This fact upsets him.

## TUESDAY

- *There are a lot of problems in the “Coffee House” division.*

The workweek schedule was changed. Before, employees worked three days a week for 10 hours a day. Now they will work five days a week for six hours a day. Some employees do not support this decision. Their representatives waited for Aleksey so they could talk over this problem. Discussion continued one and a half hours, after which the representatives understood the reasons for changing the schedule and were satisfied with the decision.

- *Meeting with “Coffee House” chief manager.*

The main topic was methods for managing change in a way that would facilitate a positive labor-management relationship. Aleksey shared his own experience in change promotion and implementation. Then they discussed a growth strategy for this business

and opportunity for “Coffee House” to develop new coffee houses in new locations in bedroom communities. This conversation took one and a half hours.

- *Lunch with a potentially very profitable client. For the present time, they considered only their common intention to open a new business together. This took 2.5 hours.*

- *Phone calls from top clients, who are accustomed to “talk personally with...”*

Altogether, this took about two hours because it was necessary to talk briefly with such important people.

- *Developing common approach to computing financial indicators and ratios.*

There are three similar (but not identical) methods of financial reporting now used in the company. Discussion of this issue with the accountants took a considerable amount of time (one and a half hours).

- *Working out the list of financial documents needed for analysis. 40 min*

That day Aleksey left the office late in the evening.

#### WEDNESDAY.

- *In the morning Aleksey dropped by “On-site Bakery” to get the last financial data.*

After 15 minutes trying to find the necessary information, he was furious. For ten minutes he tried to explain (very loudly) the meaning of efficient management. For the next 15 minutes, he could not relax or think about anything except this situation.

- *A phone call from the head of the company supplying the majority of goods for Vador’s delivery of baked goods.*

This call was made to complain about a payment schedule breach in the accounting department. The chief accountant said that payments had not been made because there

were other priorities for Vador and a lack of money. Twenty minutes were spent investigating this situation.

- *One of the line managers asked for big loan to buy a house.*

This manager has been working in the company five years and achieving great results. However, Vador now had a difficult financial situation. They spent about 30 minutes discussing all the possibilities for resolving this problem.

- *The chief accountant insisted on a private meeting. There is a great conflict between her and “Business-to-business selling of baked goods” chief manager.*

The accountant does not agree to continue using two bookkeeping systems (one for each of two currencies being used). The chief manager argued that for two top clients there is a more convenient way to pay for production in two currencies: Part of the production costs could be paid in rubles, and another part of production costs could be paid in euros. Besides, these are long-term clients, they trusted the company, and these clients have already been given approval for using these two currencies. If Vador is a customer-driven organization, they have to find a solution. The chief accountant refused point-blank and explained that such an arrangement was very dangerous in Belarus, etc. This discussion lasted one hour.

- *Again there was a complaint about the “Business-to-business selling of baked goods” division.*

Employees argued that the supply schedule was broken constantly. These breaks meant that the need for goods and the amount of inventory in the warehouse did not coincide.

Sometimes the warehouse was overstocked. Other times there was not enough inventory,

and customers had to wait for their product. Discussion of this problem with a warehouse manager and a logistic department manager took one hour.

- *Ratifying expensive agreements*, Aleksey found this to be a strategically important point because of its effect on company security. He invited a lawyer, and they discussed a new form of agreement. This took 30 minutes.
- *Paper work* took two hours (1 short phone call included).
- *Scheduled meeting in the bank*. The bank is going to change crediting conditions, so it is necessary to discuss all options. This took one hour.
- *E-mail*. This took 30 minutes.

That day Aleksey left the office late at night.

#### THURSDAY

- *Negotiations with the bank*.

Vadim phoned the office and cancelled in advance all arrangements Aleksey had made with the bank. Evidently, Vadim was right to question Aleksey's decision. This meant that Aleksey had to go to the bank promptly and continue the discussion. He had to do this before the afternoon. These negotiations with the bank took one and a half hours.

- Returning, he visited the *Price Formation Committee*.

It was necessary to identify a possible price for a new baked product in order to be consistent with government policy. In Belarus, prices for bread, milk, and other essential products are under government control. This visit took one and a half hours.

- *Lunch* took one hour.
- *Phone calls*, which were initiated by Aleksey, and e-mail took up one and a half hours.

- *Visiting possible buildings and warehouses for a future office.*

Discussing with a representative of a reconstruction company all the pros and cons of every possible building for Vador offices took one and a half hours.

- *Interview with a candidate for managing marketing in “Business-to-business selling of baked goods” division.*

Discussion of job analysis, position objectives, resume, and references of the candidate took around two hours.

- *Vadim called again, and they talked over the common situation in the firm and the bank issue. This took 40 minutes.*

Aleksey understands that his time management is extremely inefficient. Fatigue, sleeplessness, nervousness, and internal pressure all remind him of this inefficiency.

Thankfully, his wife understands him and helps him relax during the family dinner, but it is really difficult to not think about work issues at night without feeling incredible levels of stress.

After taking a Time Management course, Aleksey conducted his load audit. He knew about priorities management, the need to delegate, and the value of top managers’ time. However, he has not found any solutions for himself. All activities seem to him extremely important and extremely urgent.

THESE ARE RESULTS OF ALEKSEY’S LOAD AUDIT AND HIS REFLECTION  
ABOUT EACH POINT

Meeting with the middle- & line-managers	I tried to delegate to managers the authority for creating ideas, making proposals, and managing meetings. However, this does not work because the managers lack the skills necessary to accomplish these
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	<p>tasks. Also, to tell the truth, they do not show interest in such activities.</p> <p>As a rule, their statements are too general and boring. Vadim or I have to do this ourselves.</p>
Financing of Divisions	<p>Most likely I should give this task to division managers. Although I realize that it is dangerous to lose control of a situation, it is common knowledge that the natural tendency for a divisional structure involves some parts' spinning off on their own. However, I still believe I should give this task to the division managers.</p>
Negotiations with top clients	<p>I like it, and I do it well. Also, I do not want to lose long-term trusting relationships with key customers and lose the opportunity to get valuable feedback from them.</p> <p>It may seem that it is right to give this networking responsibility to the sales department, but top clients may be offended.</p> <p>I tried several times to accomplish this transition. However, sales employees avoided working with such clients and preferred continuing to work with "their" clients. Sales employees explained that there was not enough information and status for them to communicate with such clients. They felt uncomfortable communicating with such important people.</p>
Daily problems inside the divisions.	<p>Obviously, we should not interfere with management in divisions; and we do not interfere when the managers can manage themselves. If they cannot, we have to improve the situation.</p> <p>A huge amount of time is spent explaining the principles of Human</p>



Resource Management (HRM), leadership, daily process of management, and entrepreneurship.

Also, this is a risk issue. Our money is in this firm, and a serious wrong decision has an immediate effect on our profit.

In addition, the three division managers are so different!

- Komarov Pavel (“Business-to-business selling” division) is talented, involved, and has great perspectives. However, he lacks experience and avoids making serious decisions himself.
- Burkun Nikolay (“Coffee House”) is a great entrepreneur who is able to find opportunity for business development. As usual, he offers very interesting, attractive, and valuable options. BUT! He is a terrible manager. He tries doing everything himself, and there is never any system or order in his division. Other divisions and departments are not satisfied working with his division because coordination with the division is really complicated.
- Soldatov Ivan (Production) has a high level of seniority. He has been managing different production departments for more than twenty years. There is absolute order in his division, and his management style represents a classic mechanical one. This style is not bad for mass production, but any change in this division meets tremendous resistance. Also, Ivan’s style of HRM does not correspond well with the Vador organizational culture. With

	<p>typical products, effectiveness of this division is excellent.</p> <p>However, any new product implementation takes too much time and makes everyone nervous.</p>
Ratifying expensive agreements	<p>You see, expensive agreements are our risks. It is necessary to have so much information for such decision-making, and only top managers have this information.</p>
Relationship between employees from different departments	<p>I tried to keep myself removed from all their relationships, scandals, and grievances. However, Vadim blamed me for ignoring an important part of my managerial job. He believes that the creation and monitoring of within-company relationships are the duties of top managers and leaders.</p>
Human Resource Management	<p>This is one of the crucial issues (hand-in-hand with financing of the company). That is the reason why I try to conduct recruiting interviews with almost all employees (except laborers and other low-level employees).</p>
The policy of “open door” for every employee	<p>This is part of our organization culture. The possibility of meeting with top managers is one of the cornerstones of our management. This allows us to control situations while being in the center of events.</p>
Financial analyses	<p>Maybe I should give this task to the chief of the accounting department. She is a very intelligent person.</p>
Identifying company strategy	<p>Yes, I would like to be maximally involved in identifying company strategy. However, Vadim prefers doing it himself and does not want to settle accounts with my opinion. Sometimes it seems to me that he</p>

	needs me only as a listener.
Company planning	Of course, this is my job; but, you know, after the plan is completed, Vadim sometimes likes to say that we will do everything differently.
Price Formation Committee and other powerful stakeholders	Either Vadim or I have to do this because they refuse to communicate with lower level employees.
E-mail	Of course, I must do it myself; but it takes a huge amount of time. It is necessary to prepare intermediate responses for some messages.

#### THE TASK

- Read this case carefully. Define priorities for each of Aleksey's activities.
- Classify each activity as A, B, or C tasks (where A tasks are the most important ones that Aleksey must complete himself, and C are the least important tasks that usually can be delegated).
- Justify your decisions to classify tasks as A, B, or C
- Give your advice for planning A tasks and for Aleksey's finding time for all A tasks.
- For B and C tasks, give your ideas about delegation. You should decide the person to whom Aleksey can delegate each task and offer the appropriate approach to delegating the task.
- Share and discuss your ideas in your small groups. Be ready to present your decision to the class.

## INSTRUCTOR'S MATERIALS

### *Teaching Objectives*

This case can be used for the following objectives:

1. To analyze and discuss the issue of time management of *executive managers*
2. To analyze and discuss specific executive managers' activity *in small business*
3. To complete a *general and specific environment analysis* and emphasize and illustrate the role of the political, economic and cultural environment in the activity of small business
4. To acquaint students with the peculiarities of *Belarusian business environment*

### *Appropriate students for this case*

Undergraduate students, graduate students, and working professionals can complete this case. The instructor's objectives will determine the appropriateness of the case for specific groups. The analysis of the content of small business executive issues (listed here as objectives one and two) is most appropriate for a management and organization class. The analysis of Belarusian peculiarities as well as the tendency of the post-Soviet Union region development (listed here as objective four) is most appropriate for international management classes. The analysis of business environment issues (listed here as objective three) can be used in any courses addressing environment and stakeholders' analysis.

### *Case-study summary*

The case involves a top manager (the finance director) Aleksey P. Bortok, who is one of three owners and one of two executives of the small business named Vador Ltd. This company is situated and operates in Belarus (one of the former republics of the USSR).

Aleksey's activities include, firstly, the implementation of his functional responsibility as chief of the finance department; then, the activity as one of the executives and owners of the small business; and, lastly, the activities which are not directly relevant to his position.

Students should:

1. Analyze the content of the executive's activity;
2. Take into consideration both his responsibilities as an executive and as a finance person),
3. Distinguish between the essential functions and function which are not directly relevant to his responsibilities, and divide all activities into A, B, and C tasks.
  - a. *A – tasks*. Tasks essential for this position; these tasks a manager must implement himself. The delegation of A tasks is unreasonable for the main responsibilities implementation and can be dangerous from the security point of view.
  - b. *B – tasks*. Tasks essential for this position, but involving a huge volume of routine. Such tasks should be partly delegated.
  - c. *C – tasks*. Tasks insignificant or irrelevant for the position. They should be delegated.
4. For B and C Tasks, the students should find the most appropriate employees for the delegation of each activity and the best way of delegation. The students can base the classification on the methods of delegation.

#### LINE POWER

- *Line authorities* a manager empowers directly an employee according to the scalar chain. In the case of line delegation the employee takes the whole authority of decision making within the denoted bounds.

#### STAFF POWER

- *Permissive authorities* exist concurrently with the line authorities and give to the assigned people limited authorities in decision-making. The department or the employee (marketing, legislative, or HR) that have the permissive delegation, may give special information or advice to other employee how to handle a difficult situation, but cannot insist on their advice implementation. In this case an employee, who has received the new line authorities, has an additional opportunity for consultation and advising.
  - *Mandatory power* insists on concordance of any managerial decision with assigned departments or authorities. If that is the case, the manager empowered with the line authorities must ask for agreement of the department or employees with the mandatory power before making final decision.
  - *Parallel power* empowers equally several employees for decision making. Each of them may veto the decision; this motivates all contracting parties to search for decision which satisfies all sides. This process helps them to avoid hasty and one-sided conclusions.
  - *Functional power*. The functional staff of the company (finance, marketing, HR etc.) is empowered to manage the employees from the divisions within the framework of their function. This authority exists concurrently with the line power of the division manager
5. In case A - tasks the students should give the advice of the most efficient planning.

The case allows students to realize the contradiction in executive activity, to find the roots of managerial overload and stress, to summarize and put into practice their knowledge of managerial functions, roles and priorities, and to finds the appropriate ways of managerial daily operation.

Additionally, during the process of analyzing and decision making, students can take into consideration the environmental factors such as the political, economic and social situation in Belarus, and the role of different stakeholders. Also the environmental issues can be left out, if they do not corresponded to the class's goals and content.

#### *Preparation for the case*

Decide on the specific objective(s) for the case. One or more of the aforementioned objectives can be used. The objective(s) of the case determine(s) the type and amount of necessary preparation. The case usually can be completed after discussing the relevant issues (that is, the executive managers' functions, roles and priorities; the planning and delegation issues; and the role of the general and specific environment in small business activity). The case-study summary contains the material, which can be used in the pre-case discussion. Appendix C includes the material concerning the political, economic and social environment of small business in Belarus. This source as well as the list of literature references on post-Soviet Union region development can be requested for the prior reading.

#### *Procedure*

1. Give students a copy of the case, which they read before the class in which the case is completed. Additional material relating the environmental analysis (Appendix B) can be also distributed in advance. The students can read the case and the additional material in class and then complete the case, but the case usually works better if students read everything beforehand.

2. (Optional) Students complete the individual score form asking for their personal opinion about the case and their own solution of the situation. This form appears as Appendix A.
3. Identify the number of groups and the participants of each group. The appropriate number and size of the groups depends on the instructor's objectives. Groups with three to seven members generally work best.
4. Assign each student to one of the groups. You may use the personal opinion form in Appendix A to make the assignment. The use of this form is not necessary, but it does help to balance the groups on the basis of students' prior beliefs and priorities. Also, students' responses on this form can be used for discussion after completion of the debate. It is often helpful to compare initial opinions with students' views after preparing and hearing the arguments of specific groups.

If the student group include at the same time real executives or small business owners, employees, and officials, you should distribute the different types of individuals proportionally to each small group. Groups containing all such representatives show better group dynamics and help participants to fulfill a many-sided analysis of the issue.

5. Students then discuss in small groups Aleksey's goals, his prioritizations, and then divide all assigned activities between A, B, and C tasks.

For the B and C tasks, students appoint the best candidates for the delegation and choose the most appropriate methods of delegation. Usually this part of the discussion contains hot debate between real executives and employees. If the local or



governmental officials take part in the discussion, it would help students to give proper weight to relationships with stakeholders and avoid shortsighted decisions.

After the consideration of the delegation issue, students plan and schedule Aleksey's A tasks.

The result of the discussion should be recorded on the group form (Appendix A).

6. Each group presents their vision concerning each of Aleksey's activity. Then the instructor introduces the authors' solution (Appendix B).

The experience of using this case shows that the best variant of the groups' presentations is when each group and the instructor present their opinions according to *one of Aleksey's activity*, and then, after the discussion, they move to another one. This approach helps to keep the group dynamic during the whole case's analysis. Students concentrate more on the opinion of other groups and are more involved in the process of the discussion. Using the assignment seems less successful when each group presents all their positions at once.

According to the instructor's objectives, the discussion can underline different points of view.

- a. Use the case as a base for the discussion of the executive managers' activity and for the small business peculiarities
- b. You may discuss the ways in which the group developed their argument; emphasize the role of the members of the group (the executives or company's owners, employees, and state officials); and take over any difficulties the group experienced in developing the arguments.

- c. You may discuss the relationship between the students' personal views (that is, before being assigned to a position) and their views after preparing, hearing, and discussing specific arguments.
  - d. At this stage the comments about the environmental factors, such as the political, economic and social situation in Belarus are to the point.
7. As indicated above, this case can be used for more than one purpose (for example, to address the executives' priorities and small business issues; or the executives' priorities and the unfriendly business environment). If two sets of issues are addressed, it is advisable to deal with each set of issues separately and then discuss their relationship after the individual issues are addressed. For example, complete the debate, rebuttal, and discussion for the executives' functions, roles and priorities. Then go through the same process the small business issues. Finish by discussing the relationship between the executives' activities and the small business peculiarities.

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## INDIVIDUAL / GROUP SCORING FORM

	A, B, or C task	Who will accomplish the task (for B and C tasks)	Approach to delegating the task
Meeting with the middle- & line-managers			
Financing of Divisions			
Negotiations with top clients			
Daily problems inside the divisions.			
Ratifying expensive agreements			
Daily conflicts between employees from different departments			
Human Resource Management			
The policy of “open door” for every employee			
Financial analyses			
Identifying company strategy			

Company Planning			
Price Formation Committee and other powerful stakeholders			
E-mail			

A tasks	Advice for planning

## SOLUTION

	A, B, or C task	Who will accomplish the task (for B and C tasks)	Approach to delegating the task
Meeting with the middle- & line-managers	B	Top-managers, the participants of the meeting	<p>LINE POWER and PERMISSIVE POWER</p> <p>Top managers formulate the goal of the meeting and the main issues. Participants join the thematic groups. These groups are responsible for preparation, presentation and discussion of the assigned issues (<i>the line authority</i>). Concurrently the participants may request additional information or advice from top managers (<i>permissive power</i>).</p>
Financing of Divisions	B	The finance director (Aleksey); the head accountant, the accountants	<p>FUNCTIONAL POWER and MANDATORY POWER</p> <p><i>C task</i> – is a wrong answer, because it is insecure to leave all finance management (strategic issue) to the divisions. Students should take into account not only a typical division structure problem, which is the tendency of divisions to spin off on their own; but also the second problem of the Belarusian unfriendly</p>

		from the divisions	business environment. <i>A task</i> is a wrong answer too, because the decentralized control is an essential part of managing in the division structure. <i>B task</i> is a right answer. Aleksey as an executive creates strategic plans and controls the financial results of the departments' activity. The chair accountant creates procedures, asks ratification from Aleksey ( <i>mandatory power</i> ), and manages the accountants from the divisions according to these plans and procedures ( <i>functional power</i> ).
Negotiations with top clients	B-C	Top managers, Sales department	<p>PERMISSIVE AUTHORITIES and MANDATORY POWER</p> <p>It's possible to use both methods of delegation in this case depending on the type of client. If the client is a very valuable stakeholder, it is more efficient to apply empowerment through the <i>permissive authorities</i>. So, the executive creates the relationship with the client at the initial stage, then he introduces the empowered employee to this client, and continues to support the employee with information and recommendations.</p> <p>In other cases it is possible to impart all information about the client to the sales department and empower them to cooperate with the client at all stages of the relationship. All expensive agreements above the sum</p>

			total N must be ratified ( <i>mandatory power</i> ).
Daily problems inside the divisions.	C	Heads of the departments; functional staff of the head company	LINE POWER and PERMISSIVE AUTHORITIES “Management by objectives” and the principle of decentralization are in the base of this solution. The only right way here is to empower the department heads to manage their teams ( <i>line power</i> ). If they need recommendations or professional support, they can request these from the functional departments, such as finance, legislative, HR, or marketing ( <i>permissive authorities</i> ).
Ratifying expensive agreements	A, B	Top managers, functional staff of the head company	MANDATORY POWER and/or PARALLEL POWER The top managers can ratify the expensive agreements themselves (A task) or request ratification by one or two functional departments (B task). <i>Mandatory power</i> is used in both these cases. It is also possible to empower several functional departments to ratify the expensive agreement in coordination until they found the decision which satisfies all sides ( <i>parallel power</i> ). It will be the best solution when the top managers are out of the country.
Daily conflicts	C	Functional staff of the	FUNCTIONAL AUTHORITIES The functional staff of the head company is supposed to create the policy and procedure and manage the



between employees from different departments		head company	people from the division concurrently with the heads of the departments ( <i>functional power</i> ). Top managers can be involved in such problems if only the high-level people participate in the conflicts.
Human Resource Management	C (in exceptional cases it can be B)	Top managers, heads of the divisions, functional staff of the head company, outsourcing	LINE POWER, PERMISSIVE AUTHORITIES, and MANDATORY POWER The heads of the divisions make the decisions in the human resource (HR) area ( <i>line power</i> ). HR department implements HR planning and attracting applicants and prepares the recommendations for the head of the department ( <i>permissive authorities</i> ). Depending on the vacant position the recruiting stage is implemented by the head of the department ( <i>line power</i> ) or through ratification by the top managers ( <i>mandatory power</i> ).
The policy of “open door” for every employee	A		Aleksey reserves time in his schedule and keeps it. Employees of the company know and use the special procedure of requesting a meeting.
Financial analyses	B		FUNCTIONAL AUTHORITY The head accountant and the accountants from the divisions implement the computation of the prime

			finance coefficients ( <i>functional power</i> ). Aleksey as the finance director fulfills the managerial analysis of these data.
Identifying company strategy	A B	Top managers (Vadim and Aleksey)	PARALLEL POWER The top managers divide the area of competency in strategic management between the two of them. Each of them is responsible for decision making in his area, the other top managers trust his partner. They must discuss and ratify the strategic and high-risk decisions ( <i>parallel power</i> ).
Company Planning	B	Aleksey, The heads of the departments	MANDATORY POWER and LINE POWER The hierarchy of planning and “Management-by-objectives” should be fulfilled in the company. Aleksey accomplishes the planning of the company’s activities. The chairs of the departments prepare the departments’ objectives and adjust them with the top-managers and then report the results ( <i>mandatory power</i> ). The chairs of the departments are empowered to fulfill the planning in their department ( <i>line power</i> ).
Price Formation Committee	B (in exceptional	Top managers, employees	LINE POWER and PERMISSIVE AUTHORITIES The top managers perform the initial stage of relationship creation with the state and local stakeholders. In exceptional cases they continue to

and other powerful stakeholders	cases it can be A)		maintain ( <i>A task</i> ). For the most part this activity is delegated to the specially trained employees ( <i>line power</i> ). The employees have the opportunity to request information or help from the top managers ( <i>permissive power</i> ).
E-mail	A, C		<p><b>LINE POWER</b></p> <p>Aleksey divides the e-mail information by “important” and “less important”; and by “personal” and “official”. He empowers the assistant (secretary) to answer official and less important messages.</p>

#### RECOMMENDATIONS ACCORDING ALEKSEY’S A TASKS

Participation in the working out of Vador’s strategy	Vadim and Aleksey plan in advance the time that is necessary for carrying out this task. This period of time should be released from the daily activities. The most efficient way is to choose the “dead season”; for instance, it can be the first week after the New Year celebration.
Managerial analysis of the finance indicators	The necessary time should be reserved in advance and released from the daily activities. It can be, for example, the afternoon of the last Thursday of each month.
The initial stage of relationships with	It should be strictly planned in advance. It is necessary

the powerful stakeholders (VIP-clients, state and local officials)	to avoid the situation when the employees say that “the client can meet you right now”.
Setting objectives and controlling for the divisions	It should be the same day of the year or of the quarter (depending on the issue). This activity must be planned in advance. It is necessary to avoid the situation when the head of the department “drops by the main office and by the way shows the draft of the plan”.
“Open door” policy	“Open door” hours must be planned. It is efficient to reserve the hours when Aleksey is not busy with high priority activities.
Ratifying the expensive agreements	It’s possible to schedule these tasks at the same time every day (for instance, the first hour after his lunch or the last hour before the lunch).
The most important and personal e-mail	To avoid doing it throughout the day, the more efficient way is to devote to the e-mail time when he has already completed all scheduled high priority task (for instance, the last hour of the workday). It can be twice a day (before lunch and at the end of the day).

For the realization of all these recommendations it is useful to improve the organizational structure and procedures of the Vador Ltd.

# **Apple Computer Incorporated: Hardware & Software Segments of the Computer Industry**

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## **ABSTRACT**

Steve Jobs, Apple Computer Inc.'s CEO was faced with a key problem in year 2001; How to turnaround Apple to boost its appeal among customers and gain a bigger market share in the intensely competitive and saturated Personal Computer (PC) market? This led Apple to change its strategy by urging customers to "Think Digital". The main core strategy was making the PC, in Apple's case, the iMac the digital hub for devices. The main task was to differentiate Apple from its competitors and to gain market share in the aggressively competitive PC environment over the intermediate and long-term future.

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## **INTRODUCTION**

The situation in the hardware and software computer industry was intensely competitive.

And, Steve Jobs, Apple Computer Inc.'s co-founder and CEO was faced with a key problem in 2001: how to turnaround Apple in an attempt to boost its appeal among customers and gain a bigger market share in the highly competitive and saturated Personal Computer (PC) market. Apple had faced a dramatic decline in worldwide PC sales as its share was cut by two thirds over a period of four years from 1993-97 [S&P Industry Survey, 2001B]. This led Apple to change its strategy by urging customers to "Think Digital". The main core of the strategy was making the PC, in Apple's case the iMac, the digital hub for devices such as cameras and other peripherals. In July 1997, chairman and CEO Dr. G. Amelio resigned and Steve Jobs, Apple's original founder, took the helm as CEO, who gave the turnaround strategy a great boost. The company refreshed its product line in 1998 by introducing the iMac PC in different colors and its first server software, the Mac OS X. In 1999, Apple

opened a new chapter in portable computing by introducing the iBook laptop and selling built-to-order systems online. However, the company ended the year 2000 on a sour note with an industry wide slowdown and poor response for its G4 cube PC, which resulted in Apple's first unprofitable quarter in years. The main task was to differentiate Apple from its competitors, for its survival, as well as to gain market share in the aggressively competitive PC environment over the intermediate and long-term future.

In 2001, Apple had only 3% of market share in the computer industry. In the same year, the company introduced product upgrades, which included faster processors, computer peripherals such as DVD and CD burners, and an ultra slim version of the PowerBook called Titanium. The company also made a move to recover its slipping share in the education market by purchasing the software maker, PowerSchool. In addition, it opened 27 retail stores in the U.S. The company closed the year with the introduction of the iPod, which was a digital music player with a capacity to store 2,000 songs. Apple was shifting from being just a PC manufacturer to being a provider of digital products and other peripherals, and in a way trying to revive the PC market by making the iMac the digital hub for all these devices.

Apple was part of the computer industry that could broadly be divided into hardware and software segments. Lower PC prices in the hardware segment resulted in a fierce price war among PC vendors. Moreover, there was increasing consolidation in the PC segment by the top five vendors who commanded nearly half of the market share in 2001. The server market boosted by the Internet grew by 6.5% in 2000 to \$60 billion [S&P Industry Surveys, 2001B]. The trends seen in the software segment of the industry in 2001 were a movement towards cross-platform operating system, increased demand for skilled labor, and an increased problem of software piracy resulting in loss of revenues for software vendors. In light of the changing market and competitive pressures, Apple was faced in 2001, with

answering a number of strategic questions: Should Apple limit its operating system compatibility?

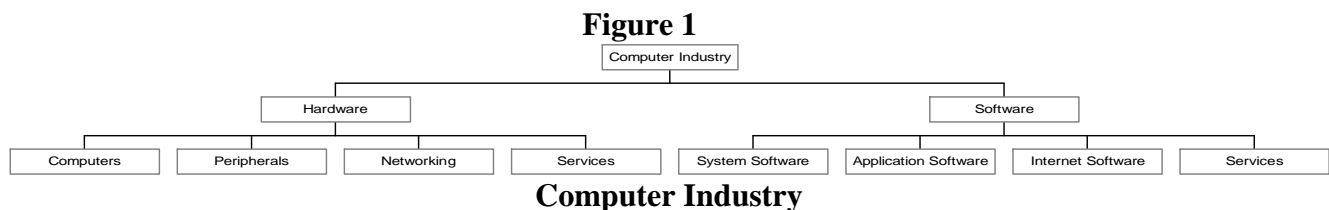
Should the company apply one-stop shopping by having multimedia and Internet capability in PCs?

How could Apple increase its market share? The crucial question to be resolved was how to differentiate Apple from its competitors and to achieve a winning edge over competitors within the

intensely competitive as well as rapidly changing market for immediate, intermediate, and long-term time frames.

## OVERVIEW: INDUSTRY ANALYSIS

The industry under study was the computer industry, which consisted of the hardware segment and the software segment, as shown in figure 1.



Each segment consisted of products, customers, technology, R&D, alliances, sales/distribution, and competition. This industry historically faced high business risk because of its emphasis on price competition, a short product life cycle, abrupt changes in growth and demand, and high investment requirements. The Internet growth stimulated the opportunity in the computer industry. The Internet access capability became part of the computer system resulting in bundling the sale of computers with the Internet software and connection.

The hardware products included computers, peripherals, networking, and services. Mainframes, servers, workstations, and personal computers fell under the computer category; while input/output devices, multimedia devices, storage devices, and entertainment devices were part of peripherals. Communication devices were part of networking and installation & maintenance and consultancy were part of services.

The software and the hardware segments were interdependent to each other as software

controlled the internal work of hardware. Software products included system software, application software, Internet software, and services. System software consisted of operating systems, compilers software, utilities software, communications software, and database management systems. Productivity software, graphic design software, application tools, entertainment software, and custom-designed software were under application software category, while e-commerce, world wide web, and intranets/extranets were part of the Internet software.

Customers in computer industry could be categorized into the education market, creative users, science & technology users, and businesses. The major players in this industry were IBM, Microsoft, Hewlett Packard, Compaq, Dell, and Apple. The recent trend for these companies was to expand to consumer electronic industry because of the saturation in the computer industry. Sony was one of the prominent players in the consumer electronic industry.

## **OPPORTUNITIES**

Foremost, there was an expansion of the digital devices and PCs convergence which created the PC as a digital hub. In addition, development of wireless technology became consumers' preference to have the Internet connection wherever they were. Moreover, the Development of Nano technology increased the microprocessor capacity and decreased the size of the microprocessor. The security software development protected the system from being attacked by viruses and outside intruders. The Demands for multimedia software sizably increased, as the industry moved towards a consumer electronic industry. Last, the important development of technology to eliminate software piracy helped deter a serious problem in computer industry.

## **THREATS**

However, there were notable threats such as that the system security was vulnerable, as the usage of the Internet grew. And, the saturation in the industry caused pricing pressure to the computer



companies. Additionally, the advance technology might not be acceptable to the consumers because it was ahead from what they needed. Consequently, there was an exceptional high cost for research and development to innovate a different computer hardware and to develop successful software.

## **KEYS TO SUCCESS**

### **Hardware Products**

Computer Mainframes provide competitive pricing, offer leasing programs, promoting sales of mainframes and offering a specialized sales force dedicated to selling of the complex mainframe equipment to corporations. Computer servers, increase the speed of the server's microprocessor, increasing the scalability of servers and competitive pricing.

Moreover, computers workstations increase graphic capabilities, increasing the performance of the microprocessor, increasing storage capacity, providing networking facilities and competitive pricing. Personal Computers enabled manufacturing platform-independent PCs and offering industrial design, and integrated digital devices with the PC. The convergence of PC with lower end products and the Internet, afforded competitive pricing.

Last, peripherals innovate products using digital and wireless technology. They offer competitive pricing, internet compatible products, implementing technology for convergence of peripherals with PCs and Internet pricing. Networking offeres easy and fast connections to the Internet, new technology to increase bandwidth capacity, broaden coverage of connectivity devices and offers wireless cross-platform communication devices. These provide efficient services, monitor quality of technicians and increase the ability to keep up with new products.

## **Software Products**

System Software and Operating Systems enable the development of cross-platform operating systems for PCs, increasing the stability of PC operating systems, applying Java technology, implementing product activation technology that incorporates firewalls and enhances selling PC operating system licenses. Moreover, system software builds platform independent compilers, using utilities software to enhance computer recovery systems, writing effective antivirus programs, and developing virus recovery software.

Communications Software, provides software that enables communication between PCs and non-PC devices, and offers non-PC communication software that can make the communication between non-PC devices. Database Management Systems increase the scalability of software, the reliability of data processing and improve the user-friendly features.

Applications Software and Productivity Software integrates all applications within productivity software, developing cross-platform software. Graphic Design Software increases the flexibility of drawing tools, increasing the capability of visual effects. Application Tools also offers cross-platform software to increase flexibility and facilitate developers' various creativities. Entertainment Software provides software that integrates entertainment devices, bundles entertainment software with the sale of PCs and writes platform-independent software.

Custom-designed software increases scalability, providing after-sale services and increases reliability. Internet Software develops cross-platform browsers and creates programs for secure online transactions, enabling online software upgrades and Internet-related consultancy.

## **Customers**

Customers include the education markets, creative users, science and technology users and businesses. The Education Markets help schools in administrative tasks, provide educational tools for teachers, assist students in making the learning process easier and help parents in tracking their

children's school progress. Creative users helps users to increase productivity, develop software with high image quality, increase the flexibility of software tools and offer high image quality devices.

Third, Science & Technology users provide stable software/hardware, and develop software with high accuracy of image viewing. Last, Businesses provide a flexible financing system with personalized consultancy.

### **Technology**

Technology provides the sale and license of product activation technology which improves the flexibility of product activation, incorporating Java technology in all software. The allocation of sufficient R&D funds provides investment in new technologies. Technology is developed according to customer preference, bringing new technology to the market before competitors and enabling the license of new technology.

### **Research and Development**

Research and Development employs knowledgeable programmers to allocate sufficient resources for effective research in developing security software. As well, R&D helps obtain patents for new software and hardware, allocating sufficient resources for digital and wireless technology. Furthermore, R&D systematically identifies customer needs, helps benchmark competition, employing knowledgeable and efficient researchers. Last, alliances enable mutually beneficial allies, providing better and more successful products.

## **Sales/Distribution**

Sales and Distribution factors are important as well. Resellers offer flexible financing plans and provide 24 hour technical support. Retailers employ knowledgeable sales force and have a solid supply management system and appreciate feedback from retailers. Moreover, online Stores provide online software demonstration. As well, online stores have a good tracking system for inventory management, providing buyer protection and guarantee security of data transmission.

## **THE COMPANY**

Apple Computer, Inc. was based in Cupertino, CA with principal activities of designing, manufacturing, and marketing of PCs and related software and peripherals for sale, primarily to the education market, creative users, science & technology users, and medium to small sized businesses. Steve Jobs and Steven Wozniak worked together to build Apple with the introduction of Apple I, designed by Steven Wozniak on April 1, 1976. The company gained recognition with the release of Apple II, which was the first PC using color graphics packaged in a plastic case. The advantages for Apple II were its low price and easy-to-use features. In 1981, IBM released its first PC and quickly dominated the PC market. To meet the competition, Steve Jobs lobbied John Scully, then president of Pepsi-Cola, to lead Apple. Under Scully's administration (1983-1993), Apple successfully introduced products such as LaserWriter and PageMaker as solutions to the publishing programs, Mac II with expandability feature, and PowerBook. Differences in opinion between Scully and Jobs led to a change in management and Jobs resignation. Later, Scully adopted an offensive strategy when he locked in a battle with Microsoft over introduction of Windows 1.0, which had many similarities with Apples Mac II GUI. Later, Bill Gates agreed not to use Mac technology in Windows 1.0, but there was no statement about future versions of Windows.

Upon introduction to the market PC cloning was the major issue since these clones ran well

with the Windows OS. In contrast, Mac OS was exclusively owned by Apple and therefore had a limited market. When Apple was finally planning to license its OS, Windows' market share was already unbeatable. Scully then tried to develop an OS that would be compatible with Intel-based computers, but he was not successful. All these led to Scully being relieved from his job by Apple's Board of Directors. Michael Spindler was appointed as next CEO. Under Spindler, Apple emphasized selling and promotion but failed to manage its production operations, which led to backorders of \$1 bln in June 1995. Apple's problems were added by the release of Windows, which performed better than Mac's OS. Spindler tackled the PC cloning problem by selling Mac OS licenses to several companies including Power Computing, the largest Mac-clone makers. From 1995 onward, Apple's performance worsened. It posted a loss of \$68 million in the last quarter of 1995. In 1996, Spindler was asked to resign as CEO and was replaced by Gil Amelio. Under his administration, Apple suffered quarterly losses in the millions of dollars through July 1997, which led to his resignation. At the end of 1996, Apple acquired NeXT and brought Jobs back as CEO.

While continuing to be innovative, Jobs aggressively built relationships with third-party software developers in an attempt to increase the availability of Mac version software. He shifted the company strategy from being a computer company to being a consumer-electronics company. Moreover, under Jobs' administration, the company entered an alliance with Microsoft to have a 5-year patent cross-license. Jobs managed to finalize the GUI argument by having Microsoft release funds to quiet the allegations of stealing Apple's intellectual property in designing Windows. In addition, Microsoft agreed to develop Office 98 software for Mac users. In the licensing issue, Apple bought back all Mac OS licenses because according to Jobs, licensing OS had cut Apple's high-end market. Jobs also made a change in selling operations by selling Apple's products through phones and the Internet. In 1998, the iMac was released. This product was targeted to low-end consumers and brought profits of \$101 million in the third quarter of 1998. This success was primarily due to its computing

power and affordable price. In 1999, iBook, a consumer portable computer, was launched and was followed by PowerMac G3, and PowerBook G3, both targeted at professionals. All these products sold well and helped to push Apple's stock upward. However, Apple failed in the next product, the PowerMac G4 Cube, resulting in suspension of this product in July 2001. This failure was caused by Cube's impractical design and high price. Later, the new line of PowerMac G4s was introduced, which came with new multimedia software including iDVD, iMovie, iTunes, and iPhoto. In January 2002, Apple made another debut by launching a sunflower-shaped personal computer, the new iMac. With its innovative industrial design and affordable price, technology analysts believed that Apple would beat the market. In October 2001, Apple released an MP3 player, the iPod, its first non-computer product. In the same year, it upgraded its OS to Mac OS X, which was based on Unix, and opened several retail stores selling not only Apple products but also third-party products, which gave added value to Apple products.

Products offered by Apple could be categorized into hardware and software offerings. Hardware products consisted of the iMac, PowerBook G4 and iBook in the personal computer category, Mac Server G4 in the entry-level server market, Power Mac G4 in the workstation category, the iPod in the peripherals category, and Airport in its networking category.

The software products comprised Mac OS X, in the system software category, and multimedia software such as iTunes, iMovie, and iDVD in the application software category. Moreover, Apple provided customers with technical support for its hardware products, and services for hardware, and consultancy for the development, and deployment of the web applications. Apple's customers included the education market, creative users, science and technology users, and medium to small sized businesses.

The education market comprised teachers, administration staffs at schools, students, and

parents. The company provided hardware such as iMac, and iBook, software such as PowerSchool, a web based student information system. In addition, it offered technical support to schools in setting up their hardware and software.

Creative users consisted of photographers, designers, web publishers, software developers, and musicians. Apple used hardware such as PowerBook G4, and iBook along with software such as iPhoto, AppleScript to target this segment. Science and Technology users included scientists such as biologists, and technical users such as software developers. Apple used its workstation, PowerMac G4, and software such as BLAST to target this category of users.

Medium to small sized businesses comprised of law firms, technical consulting firms, and health care firms. Apple used the Mac G4 server, and networking devices such as AirPort to target this segment. Apple sold its products through resellers, retailers, and its on-line store, the “Apple Store”. In 2001 Apple successfully opened 27 retail stores in the U.S. These stores carried Apple’s latest products, and had facilities such as digital screens, and a hot line called, “the genius bar”, that linked all its stores to Apple’s headquarter enabling just in time information useful to customers in making a buying decision.

In 2000, Apple spent 8% of its total revenues on R&D in an effort to develop and design PC with a unique industrial design, and advanced features. Apple realized that the future of the company, and industry relied upon new technology that simplified a customer’s digital lifestyle. This led the company to develop FireWire, a high- speed input/output technology that easily connected peripherals to a computer without the need for any other hardware. In addition, Apple had invested in making its operating system compatible to Java technology. Apple had formed a number of alliances with third-party software developers to develop software that could run on the Mac OS. Apple also formed an alliance with Microsoft under which Microsoft agreed to develop Office 98 for iMac PC users. In

addition, Apple formed a multi-year exclusive alliance with Earthlink, an ISP, to provide high speed Internet Access to its iMac PC users.

### **COMPARATIVE COMPETITIVE POSITION EVALUATION**

Apple's market share for hardware in 2001 was just 3%, competing with IBM, the leader, Compaq, Dell, and Sony. In the software segment, Apple had 1% of market share competing with Microsoft, the leader, and IBM.

Apple Products were divided into hardware and software. Apple computers included personal computers, workstations, and servers. An operating system developed by Apple was compatible only with the Macintosh computer, unlike Windows operating system, written by Microsoft, which could run on any computer with Intel microprocessor on it including computers produced by Dell, Compaq, Sony, and IBM. Producing both the computers, and operating systems would help Apple achieve better system stability, as unlike Apple, all of its competitors in the computer industry operated in either the hardware or software segment of the computer industry. However, the availability of application software for Mac users continued to be the problem since there was not much software written for Mac users as was written for Windows users. Apple products were known to be superior in design-related work, and in industrial design having sleek shape, and less cabling.

In technology, Apple developed FireWire technology that enabled digital devices to communicate with PC without the use of any additional hardware. FireWire had become the standard technology for all computers manufactured by Apple. The company's latest operating system, Mac OS X, implemented Java technology; thus, a program written on this OS could run on any computer regardless of its operating system. However, IBM, Dell, and Compaq also installed Java on their computers. As more companies implemented Java technology on their products, Microsoft dropped its support for Java-based applications on its latest operating system Windows XP because of the legal dispute with Sun Microsystems. Microsoft was the first to implement Product Activation technology in



its OS that was designed to reduce piracy.

Forming alliances was necessary for Apple to expand its customer base because of its small market share both in hardware, and in software. The company had entered alliances with Microsoft for writing Mac version of the Office software, with Earthlink to offer competitive price for Internet access service, and with the third-party software developers to increase the availability of application software written for Mac users. Microsoft had been so successful in its alliance strategy that it could have all personal computer manufacturers, except Apple, to bundle Windows and its application software with the sales of computer.

Apple spent 8% of its 2001 total revenues for R&D that was much lower than Microsoft spending on R&D, 17% of 2001 total revenues. Microsoft was ahead in finding a new way to fight software piracy. IBM allocated sufficient resources for research to put itself at the forefront of the emerging technologies such as bluetooth wireless networking, biotechnology, and Linux operating system.

With regard to its customers, Apple's performance was worse than its hardware competitors in terms of competitive pricing but superior in terms of graphic features, and the ease of use for software. In the distribution area, the company used resellers, online store, and retailers including its own retail stores to sell its products. In this area, Dell with its direct distribution model where it sold computers directly to the end-user without any middlemen had a competitive advantage over all computer companies in the industry. This model in the past helped Dell gain market share by selling computers for lower price.

### **FINANCIAL ANALYSIS OF THE OVERALL COMPANY**

Apple would focus on expanding its market share by relying on the sale of its PCs. The sale of communication devices would be tied to the sale of its PCs. This alternative was attractive because it would allow Apple to capitalize on the demand for PCs as the "digital hub", to connect all consumer

electronic devices and computer peripherals. The demand growth for PCs would be steady from 2002. According to IDC, it was expected to grow at 20% per year from 2002 onwards [S&P Industry Surveys, 2001]. Re-positioning its PC as the “digital hub” would help Apple get at least 10% of this growing PC market. Moreover, Apple would be able to gain 10% market share in the PC market as its PCs would be differentiated from those of competitors owing to unique industrial design, and better functionality. In addition, demand for digital consumer electronic devices was still in its infancy and the digital MP3 player market alone was expected to be 25 million units in 2002 [Cahners, 2001].

Apple could get at least 10% of this consumer electronic devices market because Apple would be able to differentiate its consumer electronic devices as being compatible with its PC, the iMac. The above reasoning would lead Apple to earn substantial revenues at low cost owing to its already being a veteran of the PC market, and the success of its MP3 player, iPod, in the consumer electronic market. This would in turn, lead the company to earn high net profit margins to maintain an EPS of at least 20%.

Apple would concentrate on the Computer Industry by selling PC and servers along with communication devices. In the software area, Apple would sell operating systems for PCs, and Internet software. This alternative was attractive because Apple could sell more units of its PC by re-positioning it as an “access device” to connect to the Internet. In addition, by operating in the high end, mid-range, and low-end categories of the server market, Apple would gain additional revenues. The company already had an entry-level server, Server G4, and by incorporating Linux operating system in its server, it could market this server in the mid-range category of the server market, thus gaining at least 6% of the mid-range server market share at relatively low cost.

As well, Apple would move into the consumer electronic industry along with competing in the PC and entry-level server markets of the Computer Industry. In addition, the company would diversify into other areas of the Computer Industry such as the computer services area. This alternative was

attractive because selling PCs re-positioned as the “digital hub” to connect all consumer electronic devices and computer peripherals, would help Apple to differentiate its PC from that of competitors. The PC sector was expected to grow steadily at least 20% per year over the next five years from 2002 [S&P Industry Surveys, 2001]. Apple by differentiating its PC as being a “digital hub” for connecting all consumer electronic devices could gain at least 10% of the PC market share. In addition, selling a cross-platform operating system, Mac OS X, for PCs would allow the company to gain at least 50% of the PC operating system market which at present is dominated by Microsoft. Apple would be able to grab 50% of the PC operating system market share because its operating system was more robust and less susceptible to crashes than Microsoft’s Windows Operating System. Moreover, selling consumer electronic devices compatible with non-Apple PCs would help the company gain at least 10% of the consumer electronic market share as Apple’s consumer electronic devices were superior in design, and compatible with PCs.

Entering the entry-level server market where competition was not as aggressive as the mid and high-level server market would help Apple in gaining competitive advantage. By selling software services to non-Apple users, the company could gain a stable source of revenues. This was because of high switching costs involved in changing computer service consultants. Therefore, Apple could lock in its customers. Apple already provided Internet related services, and this would enable the company gain at least 5% of the computer services market. According to IDC, spending on computer services was expected to rise about 11% in 2002 to \$429.9 billion and reach \$589 billion in 2004 growing at 11% over the next four years leading Apple to earn at least \$30 billion revenues from computer services market [Rudy, 2002].

### **LOOKING TOWARDS THE FUTURE**

Steve Jobs realized that Apple needed to expand its customer base to gain market share in the

saturated computer industry. In order to do so, Jobs had to come up with a strategy, which would help Apple differentiate itself from its competitors. One of the managers suggested to strengthen the company's position by adding a cross-platform features and re-positioning the PC as an access device rather than a productivity tool leading to a new replacement cycle in the mature PC market which accounted for 70% of sales for the computer industry in 2001.

The objective was to gain market share by converting Windows users to Mac users. To differentiate in the hardware segment, Apple would manufacture cross-platform PCs with a unique industrial designs so that Apple's PCs would not look like regular PCs sold in the market but would be more stylish in shape and in color, and would be compatible with any non-Macintosh software. In addition, Apple would produce all levels of servers from entry-level and mid-level to high-level servers and cross-platform wireless communication devices. In the software segment, Apple would develop cross-platform operating systems, so that Mac OS would be able to run on non-Mac computers. Apple would sell the OS license to third-party software developers resulting in a larger number of Windows OS users using the Mac OS which would lead to an expanded customer base, as the new Mac OS was more robust, and less susceptible to crashes than Microsoft's Windows OS.

The benefit of this strategy was to have Windows users who usually used IBM-compatible computers to run Mac OS without the need to buy Macintosh computers. In other words, Mac OS would be compatible with computers from Dell, Gateway, IBM, Compaq, and the like. Licensing its OS, together with expanding the customer base, would encourage third-party software developers to write their application software for Mac users, which was another benefit for Apple. The lack of third-party software had been the reason for new computer users not to buy Macintosh products in the first place. Manufacturing both computers and operating systems would be beneficial to the company because it could ensure the compatibility of the entire system. On the financial side, concentrating on

the computer industry would help the company to more efficiently utilize its limited financial resources to develop better quality computers and develop a better technology. This alternative was feasible because Apple was the only company, which had developed both PCs and their operating systems. Apple could convert Windows users to be Mac users because Mac OS was more robust as it was based on Unix, and Apple's cross-platform OS would offer flexibility to customers as they could run on non-Macintosh PCs. Once its customer base expanded, there would be more third-party software developers willing to write their programs for Mac users leading to an increased use of Mac OS as an alternative operating system to Microsoft's Windows. With the increase in the availability of application software, Apple would be able to persuade new computer users to purchase its products.

This strategy could win against competition because Apple had differentiated its PCs through an innovative industrial design and cross-platform. Its known-to-be robust cross-platform OS and aesthetically designed computers would provide customers with not only stable and compatible but also stylish computers. This was the strength of the company as none of its competitors offered this combination. The iMac was the first PC, which was designed with distinctive color and less cabling. Since the original iMac was launched in May 1998, Apple's stocks have surged 400% during the following two years. The company sold more than 6 million units in 2001 [Quittner, 2002]. The newest PC, the new iMac, which had a unique design and came with attached Liquid Flat screen display, was in much demand and Apple had sold 125,000 units since it was introduced in January 2002. In this strategy, Apple could win against competition because of the possibility of converting Windows users to Mac users by having a cross-platform OS. If Mac OS could run on both Macintosh computers and non-Macintosh computers such as Dell, Compaq, IBM, and HP, users would not be required to have Windows OS for their non-Macintosh computers. This would mean more flexibility for users and a loss of market share for Microsoft, its major competitor in PC operating systems.

In this strategy, Apple could win against competition because the server segment held a growth potential as companies needed servers and the relevant software to set up intranets to connect the entire organization, and to set up extranets to connect the company to all third parties such as suppliers and retailers. Apple, by developing entry-level, mid-level, and high-level servers could operate in the entire server segment, charging more competitive prices than its competitors. This would help the company establish itself in the entire server market, leading to the expansion of its customer base. In addition, Apple's innovative product, the AirPort, could help the company win against competition. Apple was the first to introduce wireless communication devices. Comparing to its competitors, Apple had a stronger position in this area. This device enabled up to 50 users to get on the Internet fast, easily, and wirelessly when they were within a radius of approximately 150 feet from the base station. Having a cross-platform AirPort, computer users could work with any PC regardless of its operating system to connect to the Internet through AirPort. For example, in a group of ten persons in which five persons used Dell PCs, three persons used iMac, and two persons used IBM PCs could wirelessly get the Internet access through AirPort. The expansion of its networking products would help Apple expand its customer base in this area.

The drawbacks would be increased software piracy problem as its customer base grew, and the difficulty to increase market share because the computer industry was very mature in early 2002. To gain market share, Apple would need to make a big effort that would use much of its resources including financial resources and human resources. The ways around these drawbacks were to implement a Product Activation technology for all software, and to develop absolutely new PCs using radical new technology such as Nano technology to revive the languid PC industry.

During this meeting, another manager suggested a more aggressive strategy by going beyond the computer industry. This strategy would involve Apple entering the consumer electronic industry. In

other words, Apple had to evolve from being a computer company to being a consumer electronic company and to add a cross-platform feature in all hardware. In order to do that, Apple would manufacture in the hardware segment personal computers, entry-level servers, multimedia devices, and communication devices. In the software segment, Apple would develop cross-platform operating systems, and offer application software such as entertainment software, productivity software as standard computer software, and browsers furthering the company's target to position the PC as an access device to connect to the Internet. Its entry-level servers would run on Linux OS. In addition to these products, Apple would have an independent department for computer services, which would be open to the opportunity of taking over or teaming up with small services providers to offer wide range of services.

The benefit was to have different sources of income by selling personal computers and operating systems separately. This led to a greater flexibility both for the company and for computer users. It was flexible, as Apple would no longer rely on just its PC sales as its revenue source. The customer would benefit, as he/she would no longer need to buy Apple's iMac PC to use the Mac OS and would not be restricted in the kind of software that would run on Mac OS, as the cross-platform OS would enable a customer to run any software written for Windows OS. Moreover, a customer could set up home entertainment by connecting entertainment devices to their PC as a digital hub without being worried about operating systems running on each device and the need for additional hardware to connect the consumer electronic devices to the PC. Offering services that were not tied to Apple's products would broaden its customer base. This would mean additional sources of income for the company. This alternative was feasible because the demand from customers to have control over their entertainment devices was felt by the computer industry, and Apple had \$4.1 bln in cash to support this expansion [Apple, 2002C]. Another feasibility was demonstrated by Apple's operating system, which had been known to be robust. Thus, a cross-platform operating system would enable the company to

get Windows OS users to use Mac OS. This would lead to an increased customer base.

This strategy could win against competition because in 2001, Apple had introduced a competitively priced MP3 player the iPod, which had brought revenues of \$50 million in the fourth quarter of 2001 [Quittner, 2002]. Its closest competitor was Sony, whose MP3 player, however, had memory of only 128MB and cost about \$200. In contrast, the iPod had a much larger memory of 10GB and cost \$399. By producing platform-independent multimedia devices, Apple would expand its customer base in the computer industry as well as in the consumer electronic industry because customers could connect these devices to non-Macintosh computers. Developing cross-platform operating systems could help Apple win against competition because it increased the availability of third-party software. This had been the major reason for computer users not to buy Apple's products. A cross-platform OS would enable customers to have Mac OS run on IBM-compatible computers, which would enable Apple to convert Windows users to be Mac users and to persuade new computer users to purchase Apple's products. Until recently, Microsoft's OS worked only with IBM-compatible computers. This cross-platform OS would cause a loss in market share for Microsoft. Selling cross-platform multimedia software as a multimedia suite could help Apple win against competition because it would help Apple expand its customer base. Apple's multimedia software was superior to Microsoft's multimedia software and it was easier to use. In addition, the cross-platform feature of the multimedia software would enable Windows OS users to use Apple multimedia software without buying an Apple PC.

This strategy could win against competition because Apple had differentiated its cross-platform personal computers through an innovative industrial design. Its known-to-be robust operating systems and aesthetically designed computers would provide customers with not only stable and compatible but also stylish computers. None of its competitors was able to offer this combination. The iMac was the



first PC in the computer industry that was designed with distinctive color and less cabling. The company had sold more than 6 million units of the iMac in 2001 [Quittner, 2002]. Producing wireless communication devices such as AirPort would help the company to win against competition. Apple was the first to introduce wireless communication devices. Comparing to its competitors, Apple had a strong position in this area because it offered a cross-platform communication device which was compatible with any PC including non-Macintosh PCs. Having a cross-platform AirPort, computer users could work with any PC regardless of its OS to connect to the Internet through AirPort. The expansion of its networking products would help Apple expand its customer base.

Producing entry-level server only could win against competition because Apple's server was superior in terms of speed and stability to its competitors' servers. Its Server G4's speed was 72% faster than Wintel, microprocessor from Intel and Microsoft. Apple's computers had been designed to be compatible with Unix, which was the base of its Mac OS X; thus, the incorporated Linux OS would not require major modifications of the computer infrastructure because Linux was an Unix-like OS. Linux had a reputation as being a very efficient and fast performing system. Offering a wide range of services could win against competition because Apple expanded its customer base. Small service providers served 76% of total computer services and IBM served only 8.9%. Generally, small service providers had an expertise in their products such as IT consolidation services, which helped companies in the merger process to manage consolidations of servers, data, applications, and networks; application management services, which helped customers manage their application portfolios; and wireless e-business services, which helped customers plan, develop, and implement wireless e-business. Forming a partnership or taking over small service providers would enable Apple to offer efficiency, expand its services without the need to train its staffs, and expand its customer base as the result of acquiring the existing customers of small companies.

The drawbacks of this alternative were a greater number of competitors because Apple competed not only with companies in the computer industry such as IBM, Dell, Compaq, and Microsoft but also with those in the consumer electronic industry such as Sony. An increase in software piracy problem was threatening as customer base grew and a heavy financial funding was required. The ways around the drawbacks were to implement Product Activation technology, to stay innovative, to differentiate the products, and to establish a better financial structure with prudent combination of equity and debt.

Considering that both alternatives would benefit Apple and could take Apple to win against the competition in the computer industry as well as in consumer electronic industry, Jobs decided to bring this matter to the board of directors and to discuss it more intensely.

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**APPLE COMPUTER INC.  
HARDWARE & SOFTWARE SEGMENTS OF THE COMPUTER INDUSTRY**

**Instructor's Guide**

**Teaching Note**

**ABSTRACT**

Steve Jobs, Apple Computer Inc.'s co-founder and CEO was faced with a key problem in year 2001; How to turnaround Apple in an attempt to boost its appeal among customers and gain a bigger market share in the intensely competitive and saturated Personal Computer (PC) market. Apple had faced a dramatic decline in worldwide PC sales as its share was cut by two thirds over a period of four years from 1993-97. This led Apple to change its' strategy by urging customers to "Think Digital". The main core of the strategy was making the PC, in Apple's case the iMac, the digital hub for devices such as cameras and other peripherals. In July 1997, chairman and CEO Dr. G. Amelio resigned and Steve Jobs, Apple's original founder, took the helm as CEO, who gave the turnaround strategy a great boost. The company refreshed its product line in 1998 by introducing the iMac PC in different colors and its first server software, the Mac OS X. In 1999, Apple opened a new chapter in portable computing by introducing the iBook laptop and selling built-to-order systems online. However, the company ended the year 2000 on a sour note with an industry wide slowdown and poor response for its G4 cube PC, which resulted in Apple's first unprofitable quarter in years. The main task was to differentiate Apple from its competitors, for its survival, as well as to gain market share in the aggressively competitive PC environment over the intermediate and long-term future.

**I. OVERVIEW AND INSTRUCTIONAL PURPOSE OF THE CASE**

By writing a report on a case study, students should develop a wide range of cognitive modeling skills specific to business and management such as heuristics, objects, diagrams, checklists along with intellectual skills and interpersonal techniques.

Cognitive skills should help students identify the problems faced by the company under study, break down the current scenario into its relevant components, define the necessary terms, and understand the technical aspects of the company. In addition, students would learn how to develop decision charts, and comparative matrix to understand the company's position relative to its competitors. Moreover, students would learn skills such as critical reasoning, analysis and synthesis should help students evaluate a situation in light of several available facts, make judgments about the trends affecting the company, and develop contingency plans to deal with the emerging trends in the overall industry.

Techniques to undertake comprehensive research to write the case study along with thorough analysis of the material researched should include time management skills. Ability to conduct research would also require familiarity with a range of business data and research sources. The analysis would require associative and inferential reasoning, to identify emerging shifting trends on studying a

company's value chain.

The overall objective of the case is to enable students to practice developing specific strategies that will differentiate their company from the competition and so enable it to win against specific competitors within the immediate, intermediate and long-term future.

Specific objectives of the case are:

- To examine the company's present situation within a given industry.
- To examine the company's strengths and weaknesses within the industry.
- To evaluate how a company reacts to opportunities and threats within an industry.
- To examine the various components within the industry and the opportunities therein.
- To evaluate how a company identifies the keys to success within an industry and uses them to gain competitive edge over its competitors.
- To evaluate how a company can develop alternative strategies to deal with a changing market place.
- To help students to examine and conceptualize a given situation in order to develop future planning skills.
- To help students in understanding the industry better and using management skills to interpret the present market situation.

## **2. THE CASE AS IT RELATES TO STRATEGIC MANAGEMENT THEORY**

The Strategic management process as explained by Donald C. Hambrick and James W. Fredrickson, has five basic steps and these can be related to the case study as well.

*Arenas* as mentioned by Hambrick and Fredrickson, are areas where a company wants to be active. In Apple Inc. case, arenas could be termed as the consumer electronics area along with computer hardware/software segments. *Vehicles* according to the theory are ways a Company would reach the Arenas. In Apple's case, the alliance strategy under which it has developed relationships with ISPs, companies such as Microsoft and third party software developers could be termed as a vehicle. The next stage is the *Differentiators* or things Company must do to win in the marketplace. In Apple's case, its image as an innovative Company coming up with good ideas could be a differentiator. The *Staging* step involves the speed and sequence of a Company's moves. In Apple's case, the introduction of the new iMac with new software to make the iMac (PC) a digital hub of all peripheral devices could be termed as a staging step. Lastly, there has to be some *economic logic* behind the new strategy. It is not enough to vaguely count on having revenues that are above costs. In Apple's case, the economic logic could be that the Company knows that consumers are willing to buy new digital products and PCs that converge with each other and the Internet enabling Apple to increase its market share form a mere 3%.

## **3. SUGGESTED DISCUSSION QUESTIONS AND ANSWERS**

### **A. Overview of the Industry**

The industry under study was the computer industry, which consisted of the hardware segment

and the software segment. Each segment consisted of products, customers, technology, R&D, alliances, sales/distribution, and competition. This industry historically faced high business risk because of its emphasis on price competition, a short product life cycle, abrupt changes in growth and demand, and high investment requirements. The Internet growth stimulated the opportunity in the computer industry. The Internet access capability became part of the computer system resulting in bundling the sale of computers with the Internet software and connection.

The hardware products included computers, peripherals, networking, and services. Mainframes, servers, workstations, and personal computers fell under the computer category; while input/output devices, multimedia devices, storage devices, and entertainment devices were part of peripherals. Communication devices were part of networking and installation & maintenance and consultancy were part of services.

The software and the hardware segments were interdependent to each other as software controlled the internal work of hardware. Software products included system software, application software, Internet software, and services. System software consisted of operating systems, compilers software, utilities software, communications software, and database management systems. Productivity software, graphic design software, application tools, entertainment software, and custom-designed software were under application software category, while e-commerce, world wide web, and intranets/extranets were part of the Internet software.

Customers in computer industry could be categorized into the education market, creative users, science & technology users, and businesses. The major players in this industry were IBM, Microsoft, Hewlett Packard, Compaq, Dell, and Apple. The recent trend for these companies was to expand to consumer electronic industry because of the saturation in the computer industry. Sony was one of the prominent players in the consumer electronic industry.

## **B. Industry Opportunities and Threats**

### Opportunities:

- Expansion of the digital devices and PCs convergence which created PC as a digital hub
- Development of wireless technology as consumers' preference to have the Internet connection wherever they were
- Development of Nano technology which could increase the microprocessor capacity and decrease the size of the microprocessor
- Security software development to protect the system from being attacked by viruses and outside intruders
- Demands for multimedia software as the industry moved towards consumer electronic industry
- Development of technology to eliminate the software piracy which was the continued problem in computer industry

### Threats:

- System security became vulnerable as the usage of the Internet grew
- The saturation in the industry caused pricing pressure to the computer companies
- The advance technology might not be acceptable to the consumers because it was ahead

from what they needed

- The high cost of R&D to innovate a different computer hardware and to develop software

## **C. Major Keys to Success**

### **Products: Hardware**

#### Computers – Mainframes

- Competitive pricing
- Offer leasing program
- Promote sales of mainframes
  - Specialized sales force dedicated to selling of the complex mainframe equipment to corporate

#### Computers – Servers

- Increase the speed of the server's microprocessor
- Increase the scalability of servers
- Competitive pricing

#### Computers – Workstations

- Increase graphic capabilities
- Increase the performance of the microprocessor
- Increase storage capacity
- Provide networking facilities
- Competitive pricing

#### Computers – Personal Computers

- Manufacture platform-independent PCs
- Offer industrial design
- Integrate digital devices with the PC
- Convergence of PC with lower end products and the Internet
- Competitive pricing

#### Peripherals

- Innovate products using digital and wireless technology
- Competitive pricing
- Offer Internet compatible products
- Implement technology for convergence of peripherals with PCs and the Internet
- Competitive pricing

#### Networking

- Offer easy and fast connection to the Internet
- Offer new technology to increase bandwidth capacity
- Broaden coverage of connectivity devices
- Offer wireless cross-platform communication devices

### Services

- Provide efficient services
- Monitor quality of technicians
- Increase the ability to keep up with new products

### **Products: Software**

#### System Software – Operating systems

- Develop cross-platform operating systems for PCs
- Increase the stability of PC operating systems
- Apply Java technology
- Implement Product Activation technology
- Incorporate a firewall
- Sell PC operating system licenses

#### System Software – Compilers Software

- Build platform-independent compilers

#### System Software – Utilities Software

- Enhance the computer recovery system
- Write effective antivirus programs
- Develop virus recovery software

#### System Software – Communications Software

- Provide software that enables communication between PCs and non-PC devices
  - Offer non-PC communication software that can make the communication between non-PC devices

#### System Software – Database Management Systems

- Increase the scalability of software
- Increase the reliability of data processing
- Improve the user-friendly features

#### Application Software – Productivity Software

- Integrate all applications within productivity software
- Develop cross-platform software

#### Application Software – Graphic Design Software

- Increase the flexibility of drawing tools
- Increase the capability of visual effects

#### Application Software – Application Tools

- Offer cross-platform software
- Increase flexibility to facilitate developers' various creativities



### Application Software – Entertainment Software

- Provide software that integrates entertainment devices
- Bundle entertainment software with the sale of PCs
- Write platform-independent software

### Application Software – Custom-Designed Software

- Increase the scalability
- Provide after-sale services
- Increase the reliability

### Internet Software

- Develop cross-platform browsers
- Create programs for secure online transactions

### Services

- Provide online software upgrades
- Provide Internet-related consultancy

## **Customers**

### The Education Markets

- Help school in administrative tasks
- Provide educational tools for teachers
- Assist students in making the learning process easier
- Help parents in tracking their children's school progress

### Creative Users

- Help users to increase productivity
- Develop software with high image quality
- Increase the flexibility of software tools
- Offer high image quality devices

### Science & Technology Users

- Provide stable software/hardware
- Develop software with high accuracy of image viewing

### Businesses

- Provide a flexible financing system
- Provide personalized consultancy

## **Technology**

- Sell the license of Product Activation technology
- Improve the flexibility of Product Activation
- Incorporate Java technology in all software
- Allocate sufficient R&D funds to invest in new technologies
- Develop technology according to customer preference

- Bring new technology to the market before competitors
- License new technology

## **R&D**

- Employ knowledgeable programmers
- Allocate sufficient resources for effective research in developing security software
- Obtain patents for new software
- Allocate sufficient resources for digital and wireless technology
- Identify customer needs
- Benchmark competition
- Develop R&D plan tailored to the company requirements
- Employ knowledgeable and efficient researchers
- Obtain patents for new hardware

## **Alliance**

- Enter mutually beneficial alliances
- Provide better and more products

## **Sales/Distribution**

### Resellers

- Offer flexible financing plans
- Provide 24 hour technical support

### Retailers

- Employ knowledgeable sales force
- Have a solid supply management system
- Highly appreciate feedbacks from retailers

### Online Stores

- Provide online software demonstration
- Have a good tracking system for inventory management
- Provide buyer protection
- Guarantee security of data transmission

## **D. Comparative Competitive Position Evaluation**

Apple's market share for hardware in 2001 was just 3%, competing with IBM, the leader, Compaq, Dell, and Sony. In the software segment, Apple had 1% of market share competing with Microsoft, the leader, and IBM.

Apple Products were divided into hardware and software. Apple computers included personal computers, workstations, and servers. An operating system developed by Apple was compatible only with the Macintosh computer, unlike Windows operating system, written by Microsoft, which could run on any computer with Intel microprocessor on it including computers produced by Dell, Compaq, Sony, and IBM. Producing both the computers, and operating systems would help Apple achieve better

system stability, as unlike Apple, all of its competitors in the computer industry operated in either the hardware or software segment of the computer industry. However, the availability of application software for Mac users continued to be the problem since there was not much software written for Mac users as was written for Windows users. Apple products were known to be superior in design-related work, and in industrial design having sleek shape, and less cabling.

In technology, Apple developed FireWire technology that enabled digital devices to communicate with PC without the use of any additional hardware. FireWire had become the standard technology for all computers manufactured by Apple. The company's latest operating system, Mac OS X, implemented Java technology; thus, a program written on this OS could run on any computer regardless of its operating system. However, IBM, Dell, and Compaq also installed Java on their computers. As more companies implemented Java technology on their products, Microsoft dropped its support for Java-based applications on its latest operating system Windows XP because of the legal dispute with Sun Microsystems. Microsoft was the first to implement Product Activation technology in its OS that was designed to reduce piracy.

Forming alliances was necessary for Apple to expand its customer base because of its small market share both in hardware, and in software. The company had entered alliances with Microsoft for writing Mac version of the Office software, with Earthlink to offer competitive price for Internet access service, and with the third-party software developers to increase the availability of application software written for Mac users. Microsoft had been so successful in its alliance strategy that it could have all personal computer manufacturers, except Apple, to bundle Windows and its application software with the sales of computer.

Apple spent 8% of its 2001 total revenues for R&D that was much lower than Microsoft spending on R&D, 17% of 2001 total revenues. Microsoft was ahead in finding a new way to fight software piracy. IBM allocated sufficient resources for research to put itself at the forefront of the emerging technologies such as bluetooth wireless networking, biotechnology, and Linux operating system.

With regard to its customers, Apple's performance was worse than its hardware competitors in terms of competitive pricing but superior in terms of graphic features, and the ease of use for software. In the distribution area, the company used resellers, online store, and retailers including its own retail stores to sell its products. In this area, Dell with its direct distribution model where it sold computers directly to the end-user without any middlemen had a competitive advantage over all computer companies in the industry. This model in the past helped Dell gain market share by selling computers for lower price.

#### **4. EVALUATION SUPPORT**

##### **A. Financial Analysis**

In case of alternative 1, Apple would focus on expanding its market share by relying on the sale of its PCs. The sale of communication devices would be tied to the sale of its PCs. This alternative was attractive because it would allow Apple to capitalize on the demand for PCs as the "digital hub", to connect all consumer electronic devices and computer peripherals. The demand growth for PCs would

be steady from 2002. According to IDC, it was expected to grow at 20% per year from 2002 onwards [S&P Industry Surveys, 2001]. Re-positioning its PC as the “digital hub” would help Apple get at least 10% of this growing PC market. Moreover, Apple would be able to gain 10% market share in the PC market as its PCs would be differentiated from those of competitors owing to unique industrial design, and better functionality. In addition, demand for digital consumer electronic devices was still in its infancy and the digital MP3 player market alone was expected to be 25 million units in 2002 [Cahners, 2001]. Apple could get at least 10% of this consumer electronic devices market because Apple would be able to differentiate its consumer electronic devices as being compatible with its PC, the iMac. The above reasoning would lead Apple to earn substantial revenues at low cost owing to its already being a veteran of the PC market, and the success of its MP3 player, iPod, in the consumer electronic market. This would in turn, lead the company to earn high net profit margins to maintain an EPS of at least 20%.

In case of alternative 2, Apple would concentrate on the Computer Industry by selling PC and servers along with communication devices. In the software area, Apple would sell operating systems for PCs, and Internet software. This alternative was attractive because Apple could sell more units of its PC by re-positioning it as an “access device” to connect to the Internet. In addition, by operating in the high end, mid-range, and low-end categories of the server market, Apple would gain additional revenues. The company already had an entry-level server, Server G4, and by incorporating Linux operating system in its server, it could market this server in the mid-range category of the server market, thus gaining at least 6% of the mid-range server market share at relatively low cost.

In case of alternative 3, Apple would move into the consumer electronic industry along with competing in the PC and entry-level server markets of the Computer Industry. In addition, the company would diversify into other areas of the Computer Industry such as the computer services area. This alternative was attractive because selling PCs re-positioned as the “digital hub” to connect all consumer electronic devices and computer peripherals, would help Apple to differentiate its PC from that of competitors. The PC sector was expected to grow steadily at least 20% per year over the next five years from 2002 [S&P Industry Surveys, 2001]. Apple by differentiating its PC as being a “digital hub” for connecting all consumer electronic devices could gain at least 10% of the PC market share. In addition, selling a cross-platform operating system, Mac OS X, for PCs would allow the company to gain at least 50% of the PC operating system market which at present is dominated by Microsoft. Apple would be able to grab 50% of the PC operating system market share because its operating system was more robust and less susceptible to crashes than Microsoft’s Windows Operating System. Moreover, selling consumer electronic devices compatible with non-Apple PCs would help the company gain at least 10% of the consumer electronic market share as Apple’s consumer electronic devices were superior in design, and compatible with PCs.

Entering the entry-level server market where competition was not as aggressive as the mid and high-level server market would help Apple in gaining competitive advantage. By selling software services to non-Apple users, the company could gain a stable source of revenues. This was because of high switching costs involved in changing computer service consultants. Therefore, Apple could lock in its customers. Apple already provided Internet related services, and this would enable the company gain at least 5% of the computer services market. According to IDC, spending on computer services was expected to rise about 11% in 2002 to \$429.9 billion and reach \$589 billion in 2004 growing at 11% over the next four years leading Apple to earn at least \$30 billion revenues from computer

services market [Rudy, 2002].

## **B. Financial Analysis Discussion**

In case of alternative 1, there were a number of risks involved, which could lead to this alternative's failing. First, the PC sector was in a highly mature stage in 2001. Price competition from sub-\$1000 PC manufactures led to very thin net profit margins for the high-end PC manufacturers in 2001. If re-positioning the PC, as a "digital hub" did not create enough demand, Apple's revenues would decline. Selling at more than \$1000 per PC, this would lead to a decrease in the company's customer demand for PCs resulting in lower revenues. If Apple sold for lower than \$1000 per PC, net profit margin would decline owing to high cost entailed in developing and re-positing the PC as a "digital hub". In addition, selling consumer electronic devices compatible with only Mac PCs may prevent Apple from gaining customers in the consumer electronic industry. This would in turn, lower demand for Apple's consumer electronic devices leading to lower revenues for the company.

In case of alternative 2, there were certain risks involved, which could result in this alternative not succeeding. Demand for PCs might not be as much as forecasted that was 20% per year from 2002. This would lead to customers becoming more prices sensitive. Therefore, Apple would have to sell its PCs at lower prices resulting in lower revenues and declining net profit margins for the company. In addition, the high end and mid range server market of the Computer Industry was highly competitive with 76% of the market share held by Compaq, Dell, and IBM. Competing in these markets would require Apple to maintain high quality standards. This would entail high cost and although the company would gain substantial revenues from this sector, the high costs could result in lower net profit margins for the company.

In case of alternative 3, there were certain risks involved which could result in this alternative not succeeding. Demand for PC as an "digital hub", might not be as much as forecasted at 20% per year from 2002 leading to customers becoming more price sensitive. This would put pressure on Apple to sell its PCs at lower than \$1000 per unit leading to lower net profit margins for the company. In addition, in case of consumer electronic devices, to keep the competitive edge, Apple would need to invest a great deal in R&D. This amount would have to come from its revenues, which could lead to lower net profit margins for the company if the new consumer electronic devices did not raise customer demand as expected. Moreover, the services segment of the computer industry involved high switching costs so that an IBM services client would have to incur high expenditure to change from IBM computer services to another computer services provider. This could restrict Apple's ability to position itself as a computer services provider, leading to low revenues.

## **C. Competitive Scenario Analysis**

Given Apple Computer, Inc.'s management decision to move from being just a computer company to being a consumer-electronic company, to develop cross-platform hardware and software, and to change the traditional look of its computer, software and hardware companies would be certain to react. Hardware companies would include not only computer manufacturers, but also entertainment device manufacturers such as Sony. Apple had introduced its entertainment product line such as iPod, an MP3 player along with multimedia software such as iPhoto, iMovie, and iDVD. Apple personal computers and portable computers come with an aesthetic industrial design and a cross-platform feature that differentiates it from its competitors.

In the alternative 1, despite Apple's low market share in the computer industry, its competitors could not overlook Apple's aggressiveness in product innovation. To compete in the PC industry, Apple had to differentiate its PCs and its operating system. Soon after Apple launched its iMac, some computer companies such as Dell and Compaq introduced their PCs with industrial design. However, their color selection was not as much as Apple's and the basic shape of the computer remained the same except that it was more compact. In the software segment, Microsoft reacted to Mac OS X, the Unix-based operating system from Apple, by introducing Windows XP. Mac OS X was more stable and robust than Mac OS 9 and so was Windows XP, which was admitted by technology analysts to be more stable and easier to use than the previous version. Moreover, Microsoft Office and Internet Explorer, both developed by Microsoft, were modified for Mac OS X.

Microsoft did not have entertainment software to compete with Apple's. Apple's applications for managing digital media which technology analysts rated as remarkable products would intrigue the third-party software developers to write similar software for Windows users which has larger customer base.

In the alternative 2, Apple would expand its products beyond PC but stay in the computer industry. To survive in this saturated industry, Apple had to be innovative and differentiate its products from its competitors by developing cross-platform features. In addition, it offered industrial design to its PCs, which was soon followed by its competitors such as Dell, HP, and Compaq. Along with its PCs, Apple developed cross-platform operating systems, which enabled it to run on non-Macintosh computers. This would lead to the possibility of persuading Windows users to switch to Macintosh products. Microsoft reacted by introducing its latest operating system, Windows XP, and developed software special for Mac users.

In the server segment, Microsoft reacted to Apple's server products by forming an alliance with Intel to develop Wintel (Windows and Intel) operating systems, which was cheaper and more stable. Dell reacted by using Linux operating system for its mid to high range servers to compete with Apple's servers in the same level.

In the alternative 3 in which Apple would evolve from being a computer company to being a consumer electronic company, its competitors in both industries reacted. Sony produced MP3 players, Networked Digital Music Player, to compete with iPod, Apple's MP3 players. Apple made a breakthrough by creating PCs with different look, adding color selections, different shape, and less cabling. Soon after the first iMac was launched, Sony, Dell, Compaq, and HP offered industrial design for their PCs to react to Apple's PCs such as iMac, new iMac, and PowerBook G4. In the software segment, Microsoft responded to Mac OS X, Apple's latest version of operating system, by introducing Windows XP. Although Microsoft had a bigger market share, it could not ignore the existence of Mac users in the PC industry; thus Microsoft agreed to modify its Microsoft Office and Internet Explorer for Mac OS X. Furthermore, it developed multimedia software to compete with iMovie, iDVD, and iTunes, Apple's multimedia software.

Dell produced entry-level servers to compete with Macintosh G4, Apple's entry-level server. However, Dell could produce its server with lower cost because of its direct distribution system.

In service, Apple's competitors would react by providing wide range of services. In this area, Apple would have difficult time to increase market share, because of IBM's strong brand name in service. Moreover, switching cost of service was high, thus, customers would not want to switch unless there was a huge benefit.

## **5. REPORT ON THE CASE STUDY**

### **A. The Company**

Apple Inc. operated in the hardware and software segments of the Computer Industry. In March 1997, Apple introduced a new business model under which it refreshed its product line by introducing the new low priced, consumer oriented PC, the iMac. In addition, the company entered the consumer electronics market with the launch of the iPod, a digital MP3 player, in 2001. Apple also simplified its software strategy with the latest version of the Mac operating system, Mac OS X, which had a compelling and easier graphical user interface, and since it was based on the Unix operating system, was more robust.

### **Products**

Products offered by Apple could be categorized into hardware and software offerings. Hardware products consisted of the iMac, PowerBook G4 and iBook in the personal computer category, Mac Server G4 in the entry-level server market, Power Mac G4 in the workstation category, the iPod in the peripherals category, and Airport in its networking category.

The software products comprised Mac OS X, in the system software category, and multimedia software such as iTunes, iMovie, and iDVD in the application software category.

Moreover, Apple provided customers with technical support for its hardware products, and services for hardware, and consultancy for the development, and deployment of the web applications.

### **Customers**

Apple's customers included the education market, creative users, science and technology users, and medium to small sized businesses.

The education market comprised teachers, administration staffs at schools, students, and parents. The company provided hardware such as iMac, and iBook, software such as PowerSchool, a web based student information system. In addition, it offered technical support to schools in setting up their hardware and software.

Creative users consisted of photographers, designers, web publishers, software developers, and musicians. Apple used hardware such as PowerBook G4, and iBook along with software such as iPhoto, AppleScript to target this segment.

Science and Technology users included scientists such as biologists, and technical users such as software developers. Apple used its workstation, PowerMac G4, and software such as BLAST to target this category of users.

Medium to small sized businesses comprised of law firms, technical consulting firms, and

health care firms. Apple used the Mac G4 server, and networking devices such as AirPort to target this segment.

### **Sales/Distribution**

Apple sold its products through resellers, retailers, and its on-line store, the “Apple Store”. In addition, in 2001, Apple opened 27 retail stores in the U.S. These stores carried Apple’s latest products, and had facilities such as digital screens, and a hot line called, “the genius bar”, that linked all its stores to Apple’s headquarter enabling just in time information useful to customers in making a buying decision.

### **R&D**

In 2000, Apple spent 8% of its total revenues on R&D in an effort to develop and design PC with a unique industrial design, and advanced features.

### **Technology**

Apple realized that the future of the company, and industry relied upon new technology that simplified a customer’s digital lifestyle. This led the company to develop FireWire, a high- speed input/output technology that easily connected peripherals to a computer without the need for any other hardware. In addition, Apple had invested in making its operating system compatible to Java technology.

### **Alliances**

Apple had formed a number of alliances with third-party software developers to develop software that could run on the Mac OS. Apple also formed an alliance with Microsoft under which Microsoft agreed to develop Office 98 for iMac PC users. In addition, Apple formed a multi-year exclusive alliance with Earthlink, an ISP, to provide high speed Internet Access to its iMac PC users.

## **B. Alternative Corporate Objectives**

### Alternative 1

Apple would focus on producing PCs as well as multimedia devices such as MP3 players, DVD players along with the related software such as iDVD, iMovie, iPhoto, and iTunes. In addition, it would develop cross-platform operating systems. The company would form alliances with third-party software developers to increase the software availability for Mac users. All computers sold would have FireWire software built into it and Macintosh operating system would be incorporated with Java technology. Apple would sell its products through resellers and retailers to reach the education market, creative users, science & technology users, and medium to small sized businesses. R&D for both computer hardware and software would be conducted in-house.

### Alternative 2

The objective for Apple was to focus on computer industry by producing cross-platform products such as PCs, servers, and communication devices, along with the related software, and offering Internet services. The company would develop cross-platform operating systems and web surfing tools. Each computer manufactured would have FireWire and USB on it and operating system would be developed with Java technology. Apple would enter into alliances with Internet services



provider, hardware manufacturers such as Sony for multimedia devices and would team up with software developers for application software. R&D for PC, operating system and application software would be conducted in-house. The company would sell its products through online stores and retailers including its own retail stores. Its customers would include the education market, creative users, science & technology users, and medium to small sized businesses.

### Alternative 3 – Chosen Alternative

The objective for Apple was to develop its PC as a digital hub with Internet access. The company would manufacture PCs, entry-level servers, and multimedia devices such as DVD players, MP3 players, and communication devices such as modem, AirPort. All devices would be cross-platform. In addition to providing services, Apple would develop cross-platform operating systems, Internet software such as browser, application software were limited to productivity software and entertainment software. FireWire and USB would be the standard technology to be built in each computer produced and its operating system would implement Java and Product Activation technology. The company would form alliances with hardware manufacturers, software developers, and Internet service providers. Apple would rely on its own researchers for R&D in PC, communication and multimedia hardware. R&D for software would be conducted in house. Distribution of its products would be through resellers, retailers including its own retail stores and online store. Its customers would include the education market, creative users, science & technology users, and medium to small sized businesses.

## **C. Evaluation And Decision**

### Alternative 1

Apple would focus on producing PCs, multimedia devices along with the software, and would continue to develop its own operating system.

The benefit to this alternative was that Apple could ensure the compatibility of Mac operating systems and Mac PCs. If an operating system was perfectly compatible with the hardware, a computer could run more stable and system crash would be unlikely to occur. Also, the company could control the distribution by either bundling the computer with the operating system or selling them separately. With the later option, other computer companies could bundle their products with Apple's operating system. For example, Dell might decide not to have Windows running on its computers, but have Mac OS instead. Another benefit was to move toward digital hub by bundling PCs and multimedia devices to take advantage of the digital growth.

This alternative was feasible because it allowed the company to concentrate the R&D fund allocation to the development of operating systems and the innovative multimedia devices where growth existed. This strategy could win against competition because the company would sell its operating system license to the cloning PC manufacturers. Thus, its sale would be independent from the sale of PCs and Apple would be able to convert Windows users to Mac users, which led to a decrease of market share for Microsoft. In addition, the company would increase the availability of third party software. The drawback of licensing would be the increase of software piracy. By not having the Internet products, the company would lose the opportunity in this potential sector. Also, without online store, the company would hinder its market expansion because of the explosion on Internet usage. To neutralize this situation, the company must innovate technology to prevent software

piracy and form alliances with the Internet companies to tap into this growing market. To increase the availability of application software, the company could team up with the third-party software developers.

### Alternative 2

This alternative was to focus on computer industry only by producing personal computers, entry-level servers and communication devices along with Internet software for Internet access purposes. All hardware would be cross-platform. Apple would develop cross-platform operating system and sell its license to third-party software developers.

The benefit to this alternative was that Apple would expand its customer base by having non-Mac computers such as Dell, Compaq to work with Mac OS. Licensing its operating system and having a cross-platform operating system would increase the availability of application software for Mac users in the market. As a producer of both the operating system and computer, Apple would be able to ensure and maintain the compatibility of the entire system. Another benefit to concentrate on computer industry was for Apple to be able to allocate its limited financial resources more efficiently by focusing on developing higher quality computers and better technology.

The alternative was feasible because Apple was the only company that developed both personal computers and operating systems, and its operating system was known to be robust. Thus, Mac OS should be running on Dell, for example, with no glitch. This would also encourage the third-party software developers to write their software for Mac users leading to the increase of software availability in the market. In turns, Apple's cross-platform operating system could lure both Windows users to convert to Mac users and new computer users to choose Mac OS over Windows. In R&D, Apple allocated sufficient funds for its researchers and programmers to stay innovative.

This strategy could win against competition because Apple had differentiated its personal computers through an innovative industrial design and cross-platform features in which none of its competitors had done it before. Thus, users would have not only stable and compatible, but also stylish computers. The iMac was the first PC in the computer industry that came with distinctive color and less cabling. The original iMac, which was launched in May 1998, surged Apple's stocks for 400% during the next two years, and has sold more than 6 million units [Quittner, 2002]. Apple has shipped 125,000 units of its sunflower-shape computers, the new iMac, since it was introduced in January 2002 and 12 million units were expected to be sold in the next three year [Reuters, 2002].

Apple could win against competition in this strategy because Apple could convert Windows users to be Mac users. Having a cross-platform operating system, computer users were not required to run Windows OS with their non-Macintosh PCs such as IBM, Dell, Compaq, and HP. This led to a greater flexibility for customers and higher numbers of software available in the market as the third-party software developers would be likely to develop software for Mac users. In this case, Microsoft could lose its market share to Apple.

Another reason that this strategy could win against competition was the fact that Apple had come out with a cutting-edge wireless communication device such as AirPort, which enabled PC users to get on the Internet fast, easily, and wirelessly within a radius of approximately 150 feet from a base station. With a cross-platform AirPort, any computer regardless of its operating system could have the

Internet access.

Entering server segment could help Apple win against competition because this segment held a growth potential as companies were needed servers and the relevant software to set up the intranets to connect the entire organization, and to set up the extranets to connect the company to all third parties such as suppliers and retailers. Apple, by developing entry-level, mid-level, and high-level servers could operate in the entire server segment, charging more competitive prices than its competitors. This would help the company establish itself in the entire server market, leading to the expansion of its customer base.

This strategy could win against competition because it was supported by the company's alliance strategy. Apple would enter alliances with the Internet service providers such as Earthlink to offer competitive pricing services, hardware manufacturers such as Dell, Compaq, IBM, and HP to bundle Apple's software with the sale of their PCs, and software developers such as Microsoft to write Mac version software.

The drawback for Apple was the difficulty to increase its market share in the computer industry because it was in the mature stage. To gain market share, Apple would be required to have huge resources including financial resources, and human resources. Also, there would be more people were attempted to pirate its software as the customer base expanded.

The ways around the drawbacks were to implement Product Activation on Mac OS to prevent software piracy, and develop new PCs using radical new technology such as Nano technology to revive the PC industry.

### Alternative 3

In this alternative, Apple would evolve to consumer-electronic company by producing personal computers, entry-level servers, multimedia devices, and communication devices. All hardware would be cross-platform. It would develop cross-platform operating systems and offer application software such as entertainment software, productivity software as standard computer software, and browsers. Apple would sell its OS license and have an independent department for computer services, which would be open to the opportunity of taking over or teaming up with small service providers to offer wide range of services.

The benefit was for Apple to have different sources of income by selling personal computers and operating systems separately. By doing this, Apple would offer flexibility to computer users meaning Windows users could use Mac computers or Mac users could use Dell computers with Mac OS running on it. The availability of software would be higher because software written for Windows would be compatible with Macintosh PCs. Also, Apple would not rely on PC sales only. Customers could set up home entertainment by connecting entertainment devices to their PCs as a digital hub while still having Internet access. Services would be another source of income because customers would always need services for many different purposes such as system consultancy, troubleshooting and upgrading.

This alternative was feasible because the demand to have entertainment devices along with computers had risen and in 2001, Apple had \$4.1 billion in cash [Apple, 2002] to support this

expansion. Moreover, the company's low debt to equity ratio, 7%, indicated that the company still had room to get external financial funding. Apple's operating system that had been known to be robust along with its easy-to-use entertainment software demonstrated another feasibility. Thus, it would be able to run on non-Macintosh computers with no glitch. Apple's ample internal financial resources, together with its stable operating system would enable the company to expand its customer base to consumer electronic industry and to encourage third-party software developers to write application software for Mac users.

This strategy could win against competition because Apple had introduced MP3 players, iPod, that was sold for \$50 million in the last quarter of 2001 [Quittner, 2002]. By producing platform-independent multimedia devices, Apple would expand its customer base in the computer industry and in the consumer electronic industry because customers could connect these devices to non-Macintosh computers. This would lead to a decrease in market share for its competitors.

Developing cross-platform operating systems and licensing them could win against competition because it would lead to an increased customer base for Apple. A cross-platform OS would enable customers to have Mac OS run on IBM-compatible computers so that Apple could convert Windows users to be Mac users and persuade new computer users to purchase Apple's products. The expansion in customer base would increase the number of third-party software developers to write application software for Mac users. The availability of application software had been the reason for computer users not to buy Apple's products. An increase in market share for Apple would mean a decrease for its competitors.

This strategy could win against competition because Apple had differentiated its personal computers through an innovative industrial design and cross-platform features. Its known-to-be robust operating systems and aesthetically designed computers would provide customers with not only stable and compatible but also stylish computers. This would put Apple in a stronger position than its competitors. The iMac was the first PC in the computer industry that was designed with distinctive color and less cabling. Since the original iMac was launched in May 1998, Apple's stocks surged 400% during the next two years. The company had sold more than 6 million units [Quittner, 2002]. The newest personal computer, the new iMac, which had unique design had been sold for 125,000 units since it was introduced in January 2002.

Producing entry-level server only could win against competition because Apple's server was superior in terms of speed and stability to its competitors' servers. Its Server G4's speed was 72% faster than Wintel, microprocessor from Intel and Microsoft. Apple's computers had been designed to be compatible with Unix, which was the base of its Mac OS X; thus, incorporated Linux operating system would not require major modifications of the computer infrastructure because Linux was an Unix-like operating system. Linux had reputation as a very efficient and fast performing system.

Apple's strategy to enter the computer services market could win against competition because offering wide range of services including the possibility to procure competitors' products would expand its customer base, which would lead to higher revenues. This additional revenue could be used by the services business unit to take over smaller service providers in the computer services market, as this market was highly fragmented with 76% of the market held by small companies. This in turn, would help Apple gain expertise from the small service companies that already had a customer base

along with the experience of doing business in the computer services market.

Lastly, this strategy could win against competition because it was supported by the company's alliance strategy. The company would form alliances with its rival in the consumer electronic industry such as Sony to have joint R&D budget, and marketing budget. Also, Apple would enter alliances with the Internet service providers such as Earthlink to offer competitive pricing services, hardware manufacturers such as Dell, Compaq, IBM, and HP to bundle Apple's products with the sale of their PCs and devices, and software developers such as Microsoft to write Mac version software.

The drawbacks of this alternative were the increased number of competitors that Apple would have to face because it would compete in two industries, an increase in software piracy problem as customer base expanded, and a heavy financial funding requirement to carry out the product expansion under this strategy.

To neutralize these drawbacks, Apple must implement Product Activation technology, stay innovative to differentiate the products, and establish a better financial structure with prudent combination of equity and debt.

#### **D. ADDITIONAL STRATEGIC FRAMEWORK RECOMMENDATIONS**

Apple could implement certain steps in order to differentiate its strategy from that of its close competitors such as Dell, IBM, Compaq, and Microsoft.

First, under the digital hub strategy, Apple could develop cross-platform PCs in order to differentiate its PCs from all its competitors. This would help Apple cover a larger market area under the Digital Hub strategy. For example, Sony MP3 player could easily be connected to the iMac and music lists could be downloaded without the Sony digital camera being compatible with the Apple software.

PCs are durable and the replacement cycle is two to three years. So Apple by being the first to come out with a cross-platform PC in the market could establish a stronghold by taking up more than 50% of the market.

To do the above, Apple needs to come up with an action plan as follows:

- 1) A good supply management system in place, so that, there are few backorders. For doing this, Apple could establish a system to work with suppliers so that suppliers could guarantee that Apple would get the parts at most competitive prices and at the right time. In return, Apple could have a exclusive relation with just a few suppliers.
- 2) A good marketing plan in place. Apple could use exhibitions, expos, TV and print advertisement, sales promotion techniques such as discounts to college students buying Apple's latest products.
- 3) Propose a patent for cross-platform technology because it would need new technology to make some changes in the PC configurations or to develop some software to make PCs cross-platform. Then, Apple could license the cross-platform technology to its competitors for a certain fee.

Apple could make the moving into the consumer electronic strategy work, by developing cross-platform multimedia software suite and cross-platform operating system for PCs. This would expand the company's market, as it would offer customers great flexibility. For example, Cannon camcorder can at present work only with Windows Operating System. But, by making multimedia software cross-platform, Apple could sell consumer electronic devices which would work with any computer irrespective of the Operating System involved.

To do the above, Apple needs to come with an action plan as follows:

- Apple could come out with new consumer electronic devices such as digital cameras and DVD players. To differentiate its consumer electronic devices, Apple could provide new and innovative multimedia software with its consumer electronic devices unlike its close competitors in the consumer electronic devices, which rely on Microsoft for their software.

Apple could make its direct selling strategy work by operating a on-line direct selling store as well as retail stores.

To do the above, Apple needs to come up with the following action plan:

- Apple could provide an interface, so that it could help customers in making their purchases. For example, if a small business wants to set up an intranet, then the on-line store interface could give suggestions about the hardware/software required and also come up with the detailed cost involved in making the purchases.

Apple could sell franchises to small companies providing computer services. In this way, the company could gain from the small companies expertise and also earn income from selling franchises. In return, small companies can use Apple's brand name and management skills, and information about the latest hardware and software developments.

## **6. THE WINNING ENTERPRISE-WIDE STRATEGY SUMMARY STATEMENT**

Apple's future strategic direction was to evolve as a player in both the Consumer Electronic industry and the Computer Industry.

Apple was the only computer company that had an integrated software and hardware business model. In other words, apple had just launched its new iMac (PC) in the hardware sector along with the new iMac operating system, Mac OS X, in the software sector. This unique business model was what differentiated Apple from its competitors such as Dell that focused only on hardware and Microsoft that was active in the software sector of the Computer Industry. This unique integration could allow Apple to come out with compatible hardware and software simultaneously gaining from economies of scope.

Apple's other strength was the unique industrial design of its computers that was apparent from its new iMac (PC) that had a different and better industrial design compared to competitors such as Dell and IBM. Moreover, Apple's multimedia software such as iPhoto, iTunes, iMusic were much better than its competitor's software. This gave the company the window of opportunity to sell its multimedia software as a software suite and gain market share. In addition, Apple was the first to come

out with the digital MP3 player called the iPod in the consumer electronic category that could be easily integrated with a desktop PC.

In the short term, Apple would gain as, although the PC sector was stagnant, worldwide PC shipments were expected to increase by approximately 20% from 2001 to 2002. The entry-level server market grew by 10% to more than \$32 billion in 2000 [S&P Industry Surveys, 2001]. Demand was buoyed by the build out of the Internet as entry-level servers could be used both as front end servers for Internet and for e-commerce. This would help Apple sell its entry-level servers.

In the intermediate future, the changing role of the PC as an access device used to connect to the Web rather than a productivity tool would create a new replacement cycle enabling Apple to sell its iMac (PC). Moreover, in 2001, the demand for low-end consumer devices such as MP3 players, and digital devices such as web-enabled phones were still in their introductory stage of growth. By launching new devices such as the iPod, Apple could take advantage of the growth potential in this segment. In addition, by creating software such as iPhoto, iMovie, iTunes and offering all such software free with its PC, Apple could further its goal to make the PC the “digital hub” of all digital devices. Besides, selling all multimedia software as a suite could help the company gain market share. Licensing its Mac OS X operating system to clone manufactures would help gain new customers. The move towards open architecture and the explosion of the Internet, had created set of standards for networking so widespread that it was becoming less important what PC one used. This would help Apple convert more Windows users to buy Mac PCs and software.

In the long-term future, technological revolution would lead to a complete new demand cycle for Apple’s computers and related software. One key technology that was expected to emerge in the next eight to ten years was Nano technology. Nano technology was basically rearranging individual atoms to create new products. Nano technology would enable building on a molecular level that was by manipulating indult atoms. In the computer industry, the ability to shrink the size of transistors on a silicon microprocessor would reach its limits by 2005-2006. Nano technology would enable Apple to build molecular computers that could contain storage devices capable of storing trillions of bytes of information in the structure of a sugar cube. It could also be used to create cheaper flat screens as in recent times demand for a liquid flat screen had increased but the screens were still very expensive to manufacture. On the whole, this new technology would lead to all current computers becoming completely obsolete creating a new demand cycle in Apple’s server, PC and Workstation categories of computers. Besides, in the long-term future, consumers would lead a digitalized lifestyle where a fridge would interact with the PC and Internet. This would give rise to demand for Apple’s consumer electronic devices, which could be easily integrated with the Internet.

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## **Atari and Infogrames Entertainment SA**

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### **ABSTRACT**

Infogrames Entertainment purchased the Atari brand name and actually renamed the firm Atari. Atari was an eighties icon for computer nerds and video game geeks who are today the parents of the interactive entertainment, multi-media, and special effects generation. Can Infogrames take the Atari brand name and use it to leapfrog industry stalwarts Activision and Take 2 and ultimately knock off Entertainment Arts from top perch in the industry?

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Bruno Bonnell, CEO of Infogrames Entertainment SA (IESA), officially announced in May 2003 that it has renamed all of its U.S. operations from Infogrames Inc. to “Atari Inc.” This was an achievement over three years in the making, in the summer of 2000, Bonnell suggested how his company will not fall victim to an acquisition or become prey to a larger company hunting to consolidate and gobble up smaller software gaming publishers. In 2000 Bonnell and IESA announced plans to purchase Hasbro Interactive, Inc. along with it the rights to the title of Atari. The deal was concluded in January 2001. By then, the video gaming industry was on the cusp of surpassing Hollywood in total annual revenues. It was obvious to Bonnell, who is an avid marathon runner, that a significant move was necessary for IESA in order for it to remain a major player in the gaming industry.

What Bonnell had seen in the industry and what was evident to software gaming publishers was the incredible growth of the gaming industry, which was then defining itself as the most lucrative entertainment industries.

*Our business has grown from a niche market for young boys and teenagers to a much broader audience, with many more adults playing. People will play games as simply as they watch TV.*<sup>59</sup>

Perhaps the connection was evident in tying in an old classic games company from the 1980s and resurrecting it in the new millennium to market to today's adults who were once the quarter feeding teenage population of that era. Atari was an eighties icon for computer nerds and video game geeks who are today the parents of the interactive entertainment, multi-media, AI, CGI special effects generation.

The gaming industry went from \$1 billion annually in video-console sales in 1982 to \$10 billion almost twenty years later. So then it was clear to Bonnell that video games were fast becoming the central source for interactive home entertainment that would soon supplant DVDs, VCRs, cable and satellite TV programming. IESA bought the Atari brand name in hopes of leapfrogging industry stalwarts Activision and Take 2 and thus ultimately knocking off Entertainment Arts (EA) from top perch. Subsequent to the acquisition came a lavish and expensive purchase for the rights to the Matrix movie sequels and thus a high debt burden on the 2002 balance sheet.

## **BACKGROUND**

In order to get a good handle on the history of Atari, it is necessary to first sketch the name Atari. Atari really has two histories: first) Atari classic -- the company that created Asteroids and, second) the history of IESA that is currently the parent company of Atari, Inc.

### ***Atari Classic***

Now Atari classic goes back to the early seventies when then a computer programmer named Nolan Bushnell created *Pong*. As one recalls, *Pong* was the game that involved two players

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<sup>59</sup> "Europe's No. 1 Video-Game Player." *Business Week*; New York; June 12, 2000.

volleying a dot back and forth on screen between their rectangular paddles. It was two-dimensional. It debuted in 1972 as an arcade machine in a tavern in Sunnyvale, CA that included a simple instruction: “Avoid missing ball for high score.” Hence, the gaming industry was born. Eventually Bushnell co-founded a computer games company with \$500 and named it “Atari” which is the term for “check” in the Japanese game of Go.<sup>60</sup> (Incidentally, *Pong* inspired Larry Probst, CEO of EA, to launch his foray into the industry) Warner Communications purchased Atari in 1976 for \$28 million. The company then launched the 2600 Video Computer System (a.k.a. 2600) in 1977. Three years later when Midway’s *Space Invaders* arrived the 2600 took on the household market by storm. The 2600 met success in the early eighties while it faced stiff competition from the likes of Mattel’s Intellivision and Coleco’s ColecoVision systems. It went on to create cartridge versions for the smash hit arcade games like Centipede, Asteroids, and Missile Command.

However, the crash of Atari classic began in 1982. By then, Bushnell had left the company after feuding with Warner Communications over the continuing development philosophy of the 2600. (An interesting side note: after Bushnell left he founded the Chuck E. Cheeses restaurant chain) *Pac-Man* was then the hot project for Atari programmers to convert the arcade game into the cartridge version. But Atari gambled and decided to manufacture the game with a cheaper 4k chip instead of 8k as suggested by the project manager. It launched prematurely and proved a failure due to the gross simplification of its graphics and technology. *Pac-Man* never took off with the 2600 and fell flat. Atari grossly miscalculated and over-

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<sup>60</sup> B.I.K.: “How Pong Invented Geekdom.” *US News & World Report*; 12/27/99, vol.127 issue 25, p.67.

forecasted the *Pac-Man* project and it paid dearly: the company went from 10,000 employees in December 1982 to just 200 by July of 1984.<sup>61</sup>

It was the beginning of the end for Atari classic. Japanese based companies Nintendo and Sega soon became the early pioneers that took the gaming industry from the eighties to the nineties. Atari classic petered out and slowly withered away in 1996 when it posted a \$13.5 million third-quarter loss due to its fledgling 64-bit Jaguar game system. Simultaneously, Sony's PlayStation and Nintendo's 64 were catching on fire. Layoffs ensued and the resignation of president of North American operations Ted Hoff signaled the end of Atari classic. That same year Atari merged with JTS, a disk drive company, which eventually folded too. In 1998, Hasbro bought the rights to Atari's home titles.

### ***Infogrames Entertainment SA***

Founded in 1983 by Bruno Bonnell and Cristopher Sapet as a software game company and based in Lyon, France. Both Bonnell and Sapet were in their twenties and invested only \$10,000 to start Infogrames. The average age of its employees back in 1987 was only 27 – an obvious reflection of the youthful vigor of the founders. The company grossed \$3.7 billion in revenues back in 1986 and by 2002 it grossed upwards near 800 euro million to become Europe's largest video-game maker. See Exhibit 1 for gross revenues.

Infogrames primarily started out offering a wide range of entertainment and educational games, developing artificial intelligence and online service software.<sup>62</sup> The company made a string of key acquisitions from the mid-nineties up through the 2000 purchase of Atari via Hasbro Interactive, Inc. See Exhibit 2 for summary of acquisitions. Of particular importance

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<sup>61</sup> Driscoll Jr., Edward B.: "The Atari 2600: The Cartridge Family Rides Again." *Poptronics*; August 2002.

<sup>62</sup>Gross, Daniel: "Infogrames: AI French Connection." *Information Today*; December 1987.

was the purchase of Shiny Entertainment studios in 2002, which held the rights to develop a game based on the movie “The Matrix Reloaded” and “Matrix Revolutions.” (Details on this strategy will be later examined in this case) Infogrames eventually produced several quality hit games in *Dragon Ball Z*, *Unreal Championship*, *Monopoly*, *Backyard Sports* to name a few; and also distributed franchise labels in movie games such as Mission Impossible, Men in Black, Stuart Little, and of course The Matrix.

But the series of acquisitions that cost about \$300 million from 1999 through 2000 combined with the development of high stakes projects such as the *Enter The Matrix* game all weigh heavily on the future profitability of Infogrames. So the current issue at hand is if the parent company, IESA, can maximize the biggest bang for every dollar spent on the Atari brand. “It can’t hurt them,” said Michael Pachter who covers Atari for Wedbush Morgan Securities. According to Goldman, Sachs & Co., Infogrames is on track to book a net loss for the fiscal year ending June 30, 2003 on revenues of \$1 billion while carrying a debt load of more than \$550 million.<sup>63</sup> Can the *Atari* name help bail IESA out of debt and launch it into its next growth phase? How long will it take for IESA to become profitable again after the costly purchase of the Matrix movie sequels?

### **THE VIDEO GAMING INDUSTRY**

In 1982, Time magazine ran a cover story on video games entitled, “Games that play people.”<sup>64</sup> The article goes on to report how the arcade game frenzy took the nation by storm as video games found their way into a variety of public domains besides the local arcade parlor: pizza shops, doctors offices, airports, restaurants, and even beauty salons.

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<sup>63</sup>Reinhardt, Andy and Ronald Grover: “Will Enter the Matrix Save Infogrames’ Skin? Europe’s Top video-game maker badly needs a blockbuster.” *Business Week*; New York; May 26, 2003.

<sup>64</sup> Skow, John: “Games That Play People.” *TIME*; January 18, 1982.

In the eighties the ideal arcade game addict was simply a teenager with a pocket full of quarters. Even so, record high scorers of such games like *Defender* needed only a quarter to play 16 hours worth of entertainment.

Now fast-forward twenty years to an article entitled, “The (R)evolution of Video games” in the November issue of *Silliconindia*, the author writes about the industry that is still made up of those same teenagers back then who are now in their thirties and still buying up video games for home entertainment.

*Its market no longer consists only of kids and teenagers, though they still comprise a large part of sales, but now the same youngsters from twenty years ago are adults with careers and money of their own.*<sup>65</sup>

The article goes on to describe how the video games industry has built a structure that is very similar to the motion picture industry. That is, when a blockbuster video game is on the drawing board large production teams are assembled with fat and costly budgets and the teams then work separately to create an entirely new and profitable product. The Hollywood-esque trend of video games production is what makes this industry so large in scale – \$10.5 billion in 2002. For example, *Enter the Matrix* cost a total of a whopping \$80 million which included all of its marketing expenses and the \$50 million it cost to acquire Shiny Entertainment. In comparison the average video game cost \$2.5 million to \$4 million to produce in 2002.<sup>66</sup> Through May of 2003, *Enter the Matrix* surpassed one million units sold and through June it surpassed 2.5 million. Activision’s *Spiderman* sold 2 million units in 2002. The industry benchmark for game title success is the one million units mark.

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<sup>65</sup> Ridlen, Richard: “The (R)evolution of Video games.” *Silliconindia*; November, 2002.

<sup>66</sup> Delaney, Kevin: “A Game Maker’s Big Gamble.” *Wall Street Journal*; New York; May 14, 2003. B1.

So then, the seventies was the video gaming industry's infantile stage with the invention of *Pong*, Atari's 2600, and finally *Space Invaders* closed out the decade in 1980; then the industry went through growing pains in the eighties with companies like Atari, Coleco, Mattel, and Magnavox all experiencing some failures with their respective hardware systems; during the eighties arcade games raked in billions annually and reached critical mass; throughout the nineties hardware console companies Nintendo and Sony began to root themselves in as the industry goliaths; and at the beginning of the new millennium the gaming industry has taken Hollywood-like shape with blockbuster movie tie-ins and gigantic budgetary projects. Lastly, the future of the gaming industry might be in online entertainment.

### ***Hardware platform***

Besides Atari classic paving the way for hardware gaming companies, Nintendo and Sega were the last few companies from the eighties that still continue in production. In 1996 two significant events occurred: Atari went out of business and Sony launched its PlayStation console game. Through 2002, Sony is the leading hardware console gaming company with their PlayStation and PlayStation 2 systems. Microsoft entered the console market in 2001 launching its Xbox system but is still a distant second. Sony's video game division contributed 53% to the company's bottom line in 2001.

On the other hand, Nintendo is more diversified in its product offerings: Nintendo 64, Gamecube's 128-bit system, and the handheld gaming devices Game Boy Advance and Game Boy Advance SP. But the company still ranks a distant third in overall sales.

Hardware companies realize that to be the market leader and gain share they also must participate in the software-publishing segment. Besides just licensing out their hardware to software developers and collect fees, they must also develop in-house software titles. All three

top hardware companies currently do so. Sony and Microsoft also try to recruit top talent away from independent software developers. However, in order not to divulge any trade secrets Sony defers to silence when probed about what strategy it will take with its next-generation PlayStation 3.<sup>67</sup>

### ***Market Demographics***

The consumer demographics for video games changed quite a bit over the past two decades. Primarily, the market has expanded in age. When the video gaming industry was initially growing throughout the eighties the teenagers who grew up playing the games just kept playing them as they got older. According to Interactive Digital Software Association, the average American gamer is 28; 58 percent of the consumers are over 18, and 21 percent are 35 or older.<sup>68</sup> So as the gamer becomes older the more likely the gamer will spend some disposable income on entertainment. Teenagers, pre-teens, and kids in general don't have as much luxury nor are they normally allowed such luxury from their parents. "The kids who fell in love with Mario when they were 6, they're now 26," says marketing director Perrin Kaplan of Nintendo.<sup>69</sup>

Nowadays, mergers and acquisitions activity is commonplace whenever software developers need to secure franchise rights to blockbuster movies. They would go out and spend millions to purchase smaller entertainment studios: If the movie is a blockbuster then the success just carries over to the planned release of its video game. And the same is true with DVDs. Gaming companies are packaging multi-media product launches. For example, the trailer for the movie will run on the DVD and vice-versa. In the case of *Enter the Matrix*, scenes were shot

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<sup>67</sup> Brown, Eryn: "Sony's Big Bazooka." *Fortune*; New York; December 30, 2002.

<sup>68</sup> Croal, N'Gai: "The Art Of Darkness." *Newsweek*; New York; June 12, 2000.

<sup>69</sup> Ibid.



specifically for the game and not for the movie, so that the consumer could play through the game while using it as a continuum for the movie. In essence, the movie just continued to live on in the game even after the end credits rolled. Take 2's purchase of Rockstar games, Atari's acquisition of Shiny Entertainment. The gaming industry has strong established relationships aligned between independent software publishers and hardware platform companies especially among the top market leaders: e.g. licensing arrangements between Entertainment Arts and Microsoft or between Atari and Sony. Under terms of agreement between the software company and the hardware company, the gaming company is authorized to develop and distribute software compatible games for the respective hardware platform.

One threat facing the software industry is piracy. Rings of alleged pirates are common in the industry. These global rings are highly sophisticated in hiding their tracks and copying and distributing the counterfeit products. Interactive Digital Software Association estimates that game-software companies lose \$3.2 billion a year due to fraud.<sup>70</sup> At highest risk are the top leading publishers: EA, Activision, Take 2, and Atari.

The video gaming industry is cyclical and is independent on the overall economy's performance. So if the economy is in a recession, the video gaming industry is not necessarily in decline too. The gaming industry cycle is first driven by the launches of the hardware platform. Whenever a next-generation system comes to market, then the industry begins a three to five year cycle. Many software companies immediately go into production to meet demand quotas forecasted for the new hardware platform. The initial two years following the next-generation hardware launch are when sales are at their highest and software companies see their inventory fly off the shelves. At the time when year three approaches, the industry reaches optimal output

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<sup>70</sup> Takahashi, Dean: "Video-Game Makers Sue Several Rings of Alleged Pirates – Racketeering Case Charges Sophisticated and Global Software – Theft System." *Wall Street Journal*; New York; Aug 16,1999

where profits are maximized and diminishing returns begin to kick in. Then, until a newer more advanced hardware platform is rolled out, the cycle begins again.

Unfortunately, software engineers are often recruited from smaller firms to the ranks of industry leaders. Keeping the talent in-house is the trick. Then managing the team of programmers is even more challenging. Getting the right mix of talent, personality, and team chemistry is vital for the development of a title game. If the chemistry or the personalities of the software developers conflict then a project could be compromised.<sup>71</sup> Atari looks overseas to Vietnam to hire sub-contractors to assist in providing additional components to some of its games. The cost savings are enormous: programmer's average annual salary in Vietnam is \$4,000 versus \$70,000 to \$100,000 in the U.S.

Gaming companies are always challenged with providing the proper age-appropriate content in the game itself. What becomes a tug-of-war battle between management and the designers is how best to make the games age appropriate. Ratings such as "M" for mature, "T" for teens, and "E" for everyone is the industry's equivalent of motion picture ratings R, PG-13, and G. Nowadays, the hot-selling title games are rated M. For instance, Take 2's *Grand Theft Auto: Vice City* is all about being a mobster, shooting cops, killing drug dealers and consorting with prostitutes. Although the game went on to become the fastest-selling video game in history, it also carried a huge risk of receiving backlash from consumer advocacy groups such as the National Institute on Media and the Family, which campaigns against excessive sex and violence.

Even family friendly Nintendo with the Donkey Kong and Mario Bros. company mascots received negative feedback when it developed under a separate label, called Rare, an M-rated game titled *Perfect Dark*. Said Bruno Bonnell of Atari, "Nintendo is the light balancing the

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<sup>71</sup> Judd, James: "Add More Quarters." *Upside*; Foster City; October 2000.

darkness of teenage games.”<sup>72</sup> Gaming companies are forced to respond to the threat of outside consumer advocacy groups tarnishing their brand image.

The video gaming sector is an intensely competitive industry. Through 2002 EA was still the industry top dog with annual sales of \$1.7 billion for fiscal 2002. Of the top five software publishers, two of them are hardware platform companies – Nintendo, Sony – as they see they must position gaming software more and more as a top core strategy (see Exhibit 3). Notice how Microsoft doesn’t even penetrate the top 10 but understands clearly that developing their own software for their console is industry wide.

However, other gaming software vendors like EA and Activision rival Atari in very similar strategies: planning, developing, publishing and distributing software game titles. Through month ending June 2003, Atari holds the number one selling video game title (see Exhibit 4). Historically, game titles go up and down the ranks and are very unpredictable after the initial sales launch. For Atari’s *Enter The Matrix* was expected to be top seller for the month after it released simultaneously with the movie counterpart. Game titles perform very similar to major motion pictures during the summer season: a blockbuster may go from top grossing film during Memorial day weekend to number five within a month. For example, Take 2’s *Grand Theft Auto: Vice City* went from number five in March 2003 and dropped all the way to number twenty just three months later. During the April to June period EA’s *NBA Street Vol. 2* remained at number five and Atari’s *Dragon Ball Z* held the number nine spot; this perhaps reflecting the fanfare for the NBA’s playoff season for the former and for the latter a strong franchise label. In any event, chart busters can go up and down the ranks within months being vulnerable to the very next hot title.

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<sup>72</sup> Croal, N’gai.

## ATARI'S GROWTH STRATEGY

After concluding a one-year survey of brand recognition around the world (Asia, Europe, South America), Bonnell announced in May 2003 that the U.S. subsidiary of IESA would be re-branded Atari Inc. In September 2003, shareholders will vote to approve a name change for the parent company IESA. Going forward management expects Atari Inc. to contribute 60-70% of the bottom line profits for IESA

According to Bonnell, the name-change strategy shouldn't be a surprise; a survey found that people over 30 tended to remember Atari and many people under 15 had their own associations with the venerable brand.<sup>73</sup> "Even if they have never played on an Atari machine, they know what *Pong* is about...older people still associate the brand with innovation," says Bonnell.<sup>74</sup> For Bonnell, being a marathon runner, the Atari acquisition was the equivalent of the moment in a race when a runner would "break away" from the competition in order to separate itself from the rest of the pack. In the fall of 2001, Atari Inc. was inaugurated (or re-inaugurated under new management) with three games: *Splashdown* and *MXRider* for PlayStation 2, and *Transworld Surf* for the Xbox.

### *Strategy*

Atari's mission is to lead mass-market demand for interactive entertainment. See Exhibit 5. This mission is not at all contrary to Bonnell's original founding goal of IESA back in 1983: to bring interactive entertainment to consumers around the world across every available distribution platform.

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<sup>73</sup> *Wall Street Journal*: "Digits." New York; N.Y.; May 8, 2003.

<sup>74</sup> *Ibid.*

Atari's vision and overall mission is clearly stated in its corporate website (Exhibit 5) in contrast to the lack of clarity among the competing top five software game publishers (Exhibit 3). Only Activision has an equally thorough and detailed explanation of its corporate objectives and goals as Atari's.

### ***Products***

Atari's core offerings include kids/family games, action/adventure games, and sports/racing games. From its founding days in 1983, Bonnell and his partner Sapet built Infogrames on an educational software game – *Le Cube Informatique*. It went on to sell 60,000 copies setting the standard for educational titles. Since the beginning of the new millennium Atari has consistently been a top 10 software gaming company worldwide and the leading software company in Europe. The company website describes itself as “one of the top 5 third-party publishers of interactive entertainment software in the world.” The description is a modest one indeed considering industry analysts consider it tops in Europe as a software publisher, and according to NPD Techworld and NPD Funworld TRSTS Video Games Service, in the U.S. Atari Inc. is tops in the following:

- *#1 publisher of Children's Entertainment games for the PC*
- *#1 publisher of Arcade and Fighting games for the PC*
- *#2 publisher of Role Playing Games for the PC*
- *#2 publisher of Family Entertainment games for the PC*<sup>75</sup>

Atari offers to the masses a wide variety of titles, franchises, and brand labels covering three major categories: movie tie-in hits, television version games, and general strategy games. In movie tie-ins Atari has licenses to Warner Bros. Looney Tunes, Mission Impossible and MI2, Men In Black, Stuart Little 2, The Matrix sequels, and Terminator 3. For its television franchise games it has developed software for the hit series Survivor and for the hit Japanese animation

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<sup>75</sup> Atari website, corporate profile at [www.atari.com](http://www.atari.com).

series Dragon Ball Z that is rated number one animation program in many countries. And in the general strategy category, Atari offers such strong brand name titles as *Monopoly*, and *Unreal Tournament*, which in 1992 won “game of the year” award and in Fall 2002 was ranked as #1 game for the PC; for the sports genre, Atari gets high marks for its *Backyard Sports* franchise. *Backyard Sports* receives positive remarks and numerous awards from parenting magazines and parenting organizations. The games basically allow the child to play sports whether its baseball, hockey, or football with the kid versions of the professional athletes. It’s basically a customized product for the children.

In terms of current usage of the brand name “Atari,” IESA has rolled out some vintage Atari games to connect the adult consumer to the eighties company that started video games twenty years ago. Atari has a “10-in-1” TV games product that the consumer gets a single joystick modeled after the classic 2600 joystick and built in the hardware the player gets 10 classic games such as Centipede, Asteroids, Missile Command, and Battlezone -- essentially, a turnkey lightweight plug-in and play system.

### ***Top Management***

There is no doubt that Atari has assembled some of the brightest and most talented senior management teams in the industry. Much of the assembly comes by way of the series of acquisitions in the late nineties (Exhibit 2). Consider Exhibit 7 listing the executives and senior management at Atari and their past accomplishments.

The management team in place at Atari is formidable to the extent that it joins together executives representing the best in class of various companies that are all leaders in the interactive entertainment world: Disney, Viacom, EA, Virgin Games, NBC. As Bonnell founded an industry start-up in 1983 on the energy and youth of eighties wiz kids, he now has built IESA

into an industry titan being managed by executives with similarly successful careers with major US corporations in the entertainment business.

However, as he has surrounded himself with top talent, some of his top management is going out the backdoor and walking across the street to the competitor. Dawn Paine, senior executive in charge of marketing left in 2002 to join Nintendo; Matt Woodley joined Sega in 2003 as European marketing director; and Larry Sparks, vice president of European marketing left just two week after Woodley.

### ***Additional Information***

In distribution Atari's global reach is in excess of 50,000 retail outlets. In Europe alone it has a network of 30,000 retail outlets and in North America it encompasses more than 22,000. Atari also distributes for its affiliate labels such as Strategy First, Xicat, and Codemasters. These affiliates outsource their outbound logistics to Atari, which ultimately gives Atari a firmer hold of the overall worldwide distribution of the video gaming industry. Atari then sets itself up to compete for the exact same distribution network of EA's: mass merchants and superstores such as Wal-Mart, electronics specialty stores like Best Buy, and software specialty stores such as Electronics Boutique.

In addition, Atari can afford to outsource all of its advertising which is common among the leading gaming companies. Advertising budgets for Atari were estimated at a \$20 million range for 2002.<sup>76</sup> Top gaming firms such as Atari typically outsource their advertising much in the way the motion picture industry firms will outsource advertising for films.

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<sup>76</sup> Flass, Rebecca and Lisa van der Pool: "Infogrames in Play." *Adweek*; Boston; March 25, 2002.

## SELECTED COMPETITOR INFORMATION

Consider the licensing arrangements and brand name titles among the competitors:

Activision has Marvel's *Spiderman*, Disney's *Toy Story 2*, and Star Trek from television; Eidos has *Lara Croft Tomb Raider*; and EA owns the Harry Potter franchise and the endless titles of sports games including the cash cow *Madden NFL*.

EA Sports has an "Its in the Game" motto. This helps its young athletic-minded audience to identify with such catch phrases as Nike's "Just Do It" signature. EA's products like *Madden NFL* have become annuities, just re-releasing the titles every year with updated versions of the players, teams, and stadiums. Fans buy it year in and year out as if the older versions go out of style like yesterday's newspaper. Thus, every year it produces a consistent stream of revenue for EA.

Take 2's *Grand Theft Auto* series is a smash hit. Take 2 does not have as much product diversification in its offerings as Atari or EA and it receives much adverse feedback from the parent population. However, Take 2 currently generates gross revenues second only to EA (see Exhibit 6).

*Take 2 made two strategic bets that paid off big...decided in 1999 to focus its development dollars on harder-edged, mature-content games...All is not rosy, to be sure. Game marketers have come under attack from groups like the National Institute on Media and the Family.<sup>77</sup>*

Even though Take 2 garners negative support among parents for its sex, drugs, and rock-n-roll image, the stock continues to perform positively. While Take 2's stock is up over the past year,

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<sup>77</sup> Brull, Steven: "Gamers II – Magazine Platinum." *Institutional Investor*; New York; February 2003.



its counterparts in EA, Activision and Atari all fell.<sup>78</sup> Much of this is due to the expanding age group of the consumer according to industry analysts.

### **THE FUTURE OF ATARI**

Can IESA take the Atari brand name and use it to leapfrog industry stalwarts Activision and Take 2 and ultimately knock off Entertainment Arts from top perch? Atari has a more recognized brand name worldwide than IESA. Family friendly products are one of Atari's core strategies; Atari offers customized sports games for children such as *Backyard Sports*. However if Atari wants to gain market share from EA's sports division, it may have to license some big household sporting names.

Atari's diverse portfolio ranging from family friendly products to blockbuster movie games similarly reflect EA's model. Bonnell took a large gamble in 2002 and spent enormously on the Shiny Entertainment acquisition to gain *Enter the Matrix*. The game has sold more than 3 million units worldwide since its May 15, 2003 launch. For the three months ending June 2003 the company's net income was positive versus the same quarter a year earlier. In fact for the quarter ending 2002 net income was negative \$709 thousand (see Exhibit 8).

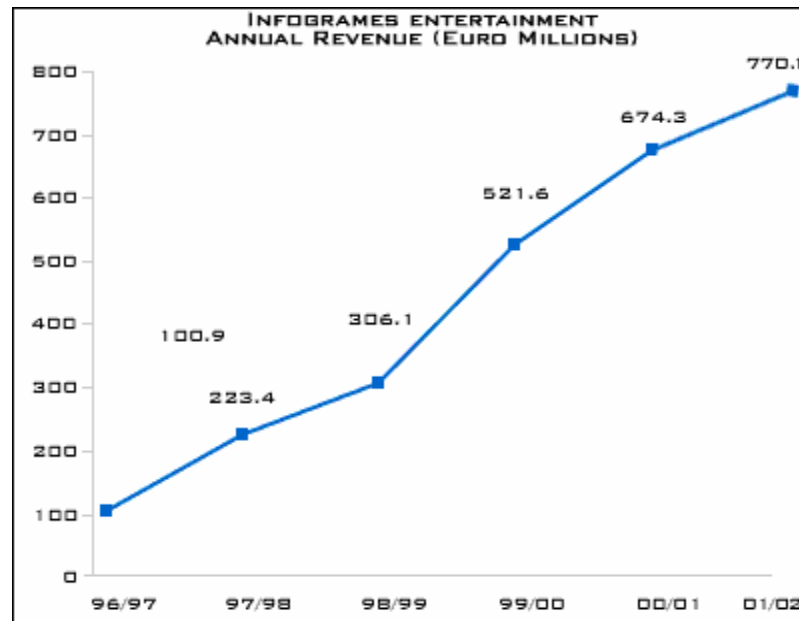
Can Atari continue to retain its design team or will it have to compete with rivals luring them away with higher compensation packages thus losing and letting go of in-house talent? As always this is a challenge industry-wide not only for Atari.

Will Bonnell succeed long-term in his re-branding efforts of adopting Atari as the company name for Infogrames? Can Atari continue to afford huge blockbuster movie games that run short-term budgetary deficits?

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<sup>78</sup> Ibid.

## Exhibit 1



## Exhibit 2

### **Infogrames Entertainment SA Acquisition History**

#### **Year: Company Acquired, Region (Activity)**

- 1996: Ocean Software, United Kingdom (Publishing)
- 1997: Philips Media, Netherlands (Distribution)
- 1998: ABS Multimedia, Portugal (Distribution)
- 1998: Arcadia, Spain (Distribution)
- 1998: Gremlin, United Kingdom (Development and Publishing)
- 1998: Game City, Switzerland (Distribution)
- 1998: Psygnosis, France (Development)
- 1999: Accolade, United States (Development and Publishing)
- 1999: Beam Software, Australia (Development)
- 1999: Ozisoft, Australia (Distribution)
- 1999: GT Interactive, United States (Development/Publishing/Distribution)
- 1999: Den-O-Tech, Canada (Development)
- 2000: Hasbro Interactive, United States (Publishing)
- 2000: Paradigm Entertainment, United States (Development)
- 2002: Shiny Entertainment, United States (Development)
- 2002: Eden Studios, France (Development)

#### **Atari, Inc.**

**Exhibit 3**

**TOP 10 Video Game Software Publishers  
ANNUAL  
2002**

<b><u>RANK</u></b>	<b><u>PUBLISHER</u></b>
1	ELECTRONIC ARTS NINTENDO OF AMERICA
2	TAKE 2 INTERACTIVE
3	ACTIVISION
4	SONY
5	THQ
6	INFOGRAMES
7	SEGA OF AMERICA
8	KONAMI OF AMERICA
9	MIDWAY
10	

Source: The NPD Group

Exhibit 4. TOP 10 VIDEO GAME TITLES

June, 2003						<b>AVG.</b>
<b><u>RANK</u></b>	<b><u>TITLE</u></b>	<b><u>PLATFORM</u></b>	<b><u>PUBLISHER</u></b>	<b><u>RELEASE</u></b>	<b><u>DATE</u></b>	<b><u>RETAIL</u></b>
						<b><u>PRICE</u></b>
1	ENTER THE MATRIX	PS2	ATARI		MAY'03	\$49
2	TOMB RAIDER: ANGEL	PS2	EIDOS		JUN'03	\$50
3	DONKEY KONG COUNTRY	GBA	INTERACTIVE NINTENDO OF AMERICA		JUN'03	\$29
4	HULK	PS2	VIVENDI		MAY'03	\$48
5	NBA STREET VOL 2	PS2	UNIVERSAL		APR'03	\$48
6	POKEMON RUBY	GBA	ELECTRONIC ARTS		MAR'03	\$33
7	POKEMON SAPPHIRE	GBA	NINTENDO OF AMERICA		MAR'03	\$33
8	DISNEY'S FINDING NEMO	GBA	THQ		MAY'03	\$30
9	DRAGONBALL Z: GOKU II	GBA	ATARI		JUN'03	\$29
10	YU-GI-OH! WORLDWIDE	GBA	KONAMI OF AMERICA		APR'03	\$35
11	BRUTE FORCE	XBX	MICROSOFT		MAY'03	\$49
12	MIDNIGHT CLUB II	PS2	ROCKSTAR GAMES		APR'03	\$47
13	GRAND THEFT AUTO 3	PS2	ROCKSTAR GAMES		OCT'01	\$20
14	DISNEY'S FINDING NEMO	PS2	THQ		MAY'03	\$39
15	ZELDA: THE WIND WAKER	GCN	NINTENDO OF AMERICA		MAR'03	\$38
16	ENTER THE MATRIX	XBX	ATARI		MAY'03	\$50
17	SPIDER-MAN: THE MOVIE	PS2	ACTIVISION		APR'02	\$19
18	MIDNIGHT CLUB II	XBX	ROCKSTAR GAMES		JUN'03	\$50
19	THE INCREDIBLE HULK	GBA	VIVENDI		MAY'03	\$29
20	GRAND THEFT AUTO: VICE CITY	PS2	UNIVERSAL ROCKSTAR GAMES		OCT'02	\$49

Source: The NPD Group

**Exhibit 5**

**Atari's Corporate Philosophy**

"Atari will lead mass-market demand for interactive entertainment."

- Bruno Bonnell, Chairman and CEO, Atari.

Atari's vision is to be the premier global source of digital interactive entertainment, transporting people of all ages and interest levels to a world of wonder and imagination by drawing from next-generation technologies.

While entertainment is at the heart of Atari's products, the company also believes that games must reward players by allowing them to follow their imagination and become immersed in new worlds and fantasies. By adapting next-generation technologies, and cultivating the imagination, innovation and energy of its people, Atari designs products that facilitate growth in the person who is playing, whether that growth is hand-eye coordination, logic skills or simply a sense of wonder and inspiration.

### **Exhibit 6. Selected Five-Year Net Revenues**

(000)	2003(1)	2002	2001	2000	1999	1998
<b>EA</b>	\$2,482,244	\$1,724,675	\$1,322,273	\$1,420,011	\$1,211,863	
<b>Take 2</b>		\$793,976	\$448,801	\$364,001	\$304,714	\$194,052
<b>Activision</b>		\$786,434	\$620,183	\$572,205	\$436,526	\$312,906
<b>Atari(2)</b>		\$770,100	\$674,300	\$521,600	\$306,100	\$223,400
(1) EA fiscal year ends March 31						
(2) revenue in euros						

### **Exhibit 7**

1. **Bruno Bonnell**, *Chief Executive Officer*: prior to founding Infogrames, Mr. Bonnell was involved in the launch of the Thomson TO7, one of the first computers designed for domestic use.
2. **Harry Rubin**, *Senior Vice President*: From 1988 to 1993, Mr. Rubin worked at NBC, where he served as Vice President and General Manager of its domestic and international Home Video Divisions.
3. **Thomas Heymann**, *Director of Digital Cost Partners*: previously, Mr. Heymann was President of The Disney Stores, Inc.
4. **Nancy Bushkin**, *Vice President, Corporate Communications*: was Vice President, Corporate Communications for Spelling Entertainment, Inc. in Los Angeles from 1997 through 1999. Prior to Spelling, she spent eight years in Corporate Relations dept. for Viacom Inc. was an integral member of communications team handling the company's acquisitions of Paramount Communications and Blockbuster.
5. **Jason Bell**, *Senior Vice President, Creative Development, Atari Inc.*: spent a year at EA serving as producer and Sr. Producer on various multi-player and online games with responsibility for product design, service quality and development planning.
6. **David Perry**, *President and Founder, Shiny Entertainment*: at age 17, Mr. Perry spent four years working for key publishers like Virgin games. He developed such hits as the Teenage Mutant Ninja Turtles and the Terminator for Orion Pictures.

**Exhibit 8**

**ATARI, INC. AND  
SUBSIDIARIES  
CONSOLIDATED  
STATEMENTS OF  
OPERATIONS**  
(in thousands, except per share  
data)

	<b>For the Three Months Ended June 30,</b>	
	<b>2002</b>	<b>2003</b>
	<b>(unaudited)</b>	<b>(unaudited)</b>
Net revenues	\$129,603	\$151,357
Cost of goods sold	60,025	70,846
Gross profit	69,578	80,511
Selling and distribution expenses	21,766	20,127
General and administrative expenses	8,497	8,548
In-process research and development	7,400	0
Research and development	21,400	22,229
Depreciation and amortization	1,918	1,950
Operating income	8,597	27,657
Interest expense, net	4,069	3,046
Other (expense) income	-3,559	118
Income before provision for income taxes	969	24,729
Provision for income taxes	1,678	937
<b>Net (loss) income</b>	<b>(\$709)</b>	<b>\$23,792</b>
Basic and diluted net (loss) income per share	(\$0.01)	\$0.34
Basic weighted average shares outstanding	69,825	69,974
Diluted weighted average shares outstanding	69,825	70,169
<b>EBITDA</b>	<b>\$10,515</b>	<b>\$29,607</b>
*	\$10,515	\$29,607
<b>EBITDA * per share</b>	<b>\$0.15</b>	<b>\$0.42</b>

## TEACHING NOTE

### Abstract

Infogrames Entertainment purchased the Atari brand name and actually renamed the firm Atari. Perhaps the connection was evident in tying in a classic games company from the 1980s and resurrecting it in the new millennium to market to today's adults who were once the quarter feeding teenage population of that era. Atari was an eighties icon for computer nerds and video game geeks who are today the parents of the interactive entertainment, multi-media, and special effects generation. Can Infogrames take the Atari brand name and use it to leapfrog industry stalwarts Activision and Take 2 and ultimately knock off Entertainment Arts from top perch in the industry?

The video games industry has built a structure that is very similar to the motion picture industry. That is, when a blockbuster video game is on the drawing board large production teams are assembled with fat and costly budgets and the teams then work separately to create an entirely new and profitable product. The Hollywood-esque trend of video games production is what makes this industry so large in scale – \$10.5 billion in 2002. The Atari of 2003 has produced several quality hit games in *Dragon Ball Z*, *Unreal Championship*, *Monopoly*, *Backyard Sports* to name a few; and also distributed franchise labels in movie games such as *Mission Impossible*, *Men in Black*, *Stuart Little*, and *The Matrix*.

### Case Uses

**Course: Business Policy and Strategy (Undergraduate or Graduate)**

**Suggested Positions in Course**

**1) Introductory case**

#### **Used as an Introductory Case**

As a first case for students unfamiliar with the course's content and, potentially, also unfamiliar with case analysis and discussion, this particular case has several benefits. First, Atari is in an industry that every student can understand and to which all students can easily relate. Second, the company in the case is responding to industry changes occurring as a result of the E-commerce revolution; again, a technological change that students can understand and to which they can relate. Finally, students can find within this case issues that have implications for the broad range of topics covered in a strategy class including:

- (1) general environment
- (2) industry environment (see Porter's (1980) 5-forces model)
- (3) internal environment resources and capabilities (see articles drawing from a resource-based perspective including Barney (1991) and Peteraf (1993))
- (4) value chain analysis (Porter, 1985)
- (5) business strategy analysis
- (6) corporate strategy

### **Teaching Objectives and Plan**

In terms of its content, writing style and length, the case should be appropriate for either senior undergraduate students or graduate students to read and understand. The case is written in a style that overviews the situation but intentionally avoids guiding students through any analytical framework or specific application question. In so doing, it provides the instructor with the latitude to adjust class discussion and thereby accommodate the abilities of a wide-range of students. Specifically, the instructor can invite better students, including graduate students, to reason through a situation where uncertainty exists and speculation is required.

The case presents a strategy formulation problem. Ideal application is as an initial case to set the stage for a graduate or undergraduate business policy and strategy course. In this setting, the primary learning objective for students is to begin to understand through case discussion some of the central topics that are part of a business policy and strategy course. In this sense, Atari provides students with a case that contains all the elements necessary to lead students through a course overview in a practical real-world setting.

It is assumed that students at this point in the class have been exposed to the various frameworks associated with all types of both internal and external environment analyses. The instructor should feel comfortable in this application being more direct in guiding the discussion



and asking students to incorporate various types of analyses into the discussion. For better students, more can be expected in this regard.

The case moves students towards two critical questions. First, there is the question of how Atari has used industry analysis to examine their industry's supplier, buyers, threats of new entry, substitutes and rivalry. Essentially, students should be thinking about Atari's strategy of differentiation within the gaming industry based on product variety and movie tie-ins.

### **Discussion Questions**

#### **1. How attractive is the software / gaming industry?**

The threat of new entrants to the industry is rather low. The high production costs, industry price wars, pre-existing licensing arrangements are the common barriers to entry. Nowadays, mergers and acquisitions activity is commonplace whenever software developers need to secure franchise rights to blockbuster movies. Firms would go out and spend millions to purchase smaller entertainment studios: Take 2's purchase of Rockstar games, Atari's acquisition of Shiny Entertainment.

Bargaining powers of suppliers is significant. Here the gaming industry has strong established relationships aligned between independent software publishers and hardware platform companies especially among the top market leaders: e.g. licensing arrangements between Entertainment Arts and Microsoft or between Atari and Sony. Under terms of agreement between the software company and the hardware company, the gaming company is authorized to develop and distribute software compatible games for the respective hardware platform.

The bargaining power of the consumer is low. When software gaming companies launch their new releases, the consumer cannot determine the final product price. Today, specialty computer games stores such as Electronics Boutique do sell marked down used games and discounted refurbished hardware systems. However that is the secondary market for used products. In the primary distribution channels such as the mass retailers like Wal-Mart and the specialty electronics stores like Best Buy, the consumer has no bargaining power over price.

The threat of substitution is significant to moderate. Video games are fast becoming a primary source for home entertainment. Substitutes for home entertainment are DVDs, VCRs, cable and satellite television programming, board playing games, novels, movies, and music. But video game playing is an escapist's culture which allows the consumer to spend hours everyday in play-mode situations: combat fighting, war battle sequences, fantasy adventures, sports games, movie script, cartoon animation, television program, etc.

Significantly, the trend today in the interactive entertainment world is that the substitute is becoming more complementary in nature, especially the Hollywood movie tie-ins with video games. If the movie is a blockbuster then the success just carries over to the planned release of its video game. And the same is true with DVDs. Gaming companies are packaging multi-media product launches. For example, the trailer for the movie will run on the DVD and vice-versa. In the case of *Enter the Matrix*, scenes were shot specifically for the game and not for the movie, so that the consumer could play through the game while using it as a continuum for the movie. In essence, the movie just continued to live on in the game even after the end credits rolled.

## **2. What is Atari's Competitive Advantage? Core competences?**

The continuation of family educational gaming software as part of its core allowed Atari to gain competitive advantages over its rivals. . Family friendly products are one of Atari's core strategies; Atari offers customized sports games for children such as *Backyard Sports*. However if Atari wants to gain market share from EA's sports division, it must continue to license some big household sporting names.

### **3. How can Atari sustain its Competitive Advantages?**

Atari's diverse portfolio ranging from family friendly products to blockbuster movie games similarly reflect EA's model. Bonnell took a large gamble in 2002 and spent enormously on the Shiny Entertainment acquisition so it can position the company for record sales with *Enter the Matrix*. The game has sold more than 3 million units worldwide since its May 15<sup>th</sup> launch. For the three months ending June 2003 the company's net income was positive versus the same quarter a year earlier. In fact for the quarter ending 2002 net income was negative \$709 thousand, see case Exhibit 8.

## **Bisleri: Muddling through Choppy Waters**

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*Presented at the REGULAR session of the Case Association 2004 Meeting*

Keywords: Bisleri, Bottled Water, Indian Bottled Water Industry, Brand Management

### **ABSTRACT**

Bisleri is aware of the lurking threat of the multinationals, Coca Cola, Pepsi, Nestle etc. who were keen on raising their stakes in the Rs 7 billion, 700 million-litre market, which had grown by 70 per cent last year. It now wonders what new initiatives can be taken to sustain the aura that had made Bisleri the generic name for mineral water in India. In this backdrop, the chairman of Bisleri Mr. Ramesh Chauhan is perplexed as to how long he could keep fighting the multinationals single handedly, and whether he should sell off his last remaining brand to some MNC heavyweight.

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### ***Teaching Objectives***

- To present differentiation strategies for low involvement products with little differences between competing brands.
- To demonstrate the modus operandi to stave of the challenge of brands offered by bigger and diversified companies, with a special focus on the context of Indian business competing with MNCs in India.
- To explain the essential needs of an exit strategy:
  - What should be the timing of exit?
  - What steps may be performed before exiting (selling-off) a brand, in order to get the best possible returns from nurturing the brand?

It is hereby declared that the data used in this case has been collected by the authors from various secondary sources. The references of these sources have been given as end notes embedded in the text.

### **A brand under siege**

The dim daylight and the mini-storm heightened the sense of unusual lull at Parle Bisleri Limited's bottling plant, by the Western Express motorway in Andheri, a suburb in northwest Mumbai. It was a rainy day in Mumbai, with the sun screened by heavy, pacy monsoon clouds, a condition similar to that of Bisleri's, thought Chauhan, Parle's Chairman and the father figure behind Bisleri's success story. He was sitting with a handful of Parle's senior executives, storming each other's brains with ideas to stave off the Cola and FMCG giants' challenge to Bisleri's hegemony in the bottled water business.

While it was a holiday for executives of all other companies, rest was the last thing on the mind of Bisleri's top brass. Bisleri not only had to retain its market share but also try and raise it.

*If it means work on holidays for the top brass, so be it. The determination to shake off the sticky image of guys who, a few years ago, succumbed to MNC pressure and sold off best-selling soft drinks brands like Thums Up, is evident. So is the urge to consolidate the good start to a new innings in mineral water.*

Chairman Ramesh Chauhan had flown in from his base in Delhi, to review the business personally and to quiz his trusted generals on aspects like design, shape, size, material of the proposed new containers for Bisleri mineral water. Everyone was aware of the lurking threat of the multinationals, Coca Cola, Pepsi, Britannia, and Nestle etc. who were keen on raising their stakes in the Rs 7 billion, 700 million-litre market, which had grown by 70 per cent last year.<sup>79</sup>

The diminutive Chauhan, wearing simple leather slippers sat examining the tamper-proof seal mechanism of a blue bottle-cap. He posed a few more questions, and aired a few suggestions. The top management team wanted to get every detail, major and minor, right.

Meeting over, Chauhan wondered what new initiatives could be taken to sustain the aura that had made Bisleri the generic name for mineral water in the country. His thoughts further strayed

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<sup>79</sup> "Mineral water is where the action is." www.rediff.com, August 25, 2000

to how long he could keep fighting the multinationals single handedly, and whether he should sell off his last remaining brand to some MNC heavyweight.

### **The International Mineral Water Industry**

The tradition of bottled water and mineral water is not very old. Even in western countries the practice of bottled drinking water started only in 1950s.

Since ancient time people have used water from mineral springs, especially hot springs, for bathing due to its supposed therapeutic value for rheumatism, arthritis, skin diseases, and various other ailments. Depending on the temperature of the water, the location, the altitude, and the climate at the spring, it could be used to cure different ailments. This started the trend of using mineral water for drinking purposes in order to exploit its therapeutic value. Since mid 1970s large quantities of bottled water from mineral springs in France and other European countries began to be exported.

The concept of bottled water is relatively successful in western countries due to greater health consciousness. The international standards regarding bottled water are so stringent that for a particular brand of water to be certified as bottled water, in most countries, multiple levels of approvals are required. For example, in the United States, the EPA (Environment Protection Agency) regulates public water systems. The FDA of US has also set standards for bottled water. It has categorized bottled or drinking water into seven different types, namely:

1. **Mineral Water:** Bottled water containing not less than 250 parts per million total dissolved solids may be labeled as mineral water. Mineral water is distinguished from other types of bottled water by its constant level and relative proportions of mineral and trace elements at the point of emergence from the source. No minerals can be added to this product.

2. **Purified water:** Water that has been produced by distillation, de-ionization, reverse osmosis or other suitable processes.
3. **Spring water:** Bottled water derived from an underground formation from which water flows naturally to the surface of the earth. Spring water must be collected only at the spring or through a borehole tapping the underground formation finding the spring.
4. Artesian Water/ Artesian Well Water
5. Distilled Water
6. Sparkling Water
7. Well Water

### **Bisleri: The Generic for Mineral Water in India**

The origins of Bisleri lie in Italy, and the brand owes its name to its founder, Mr. Felice Bisleri, an Italian entrepreneur. In 1967, Bisleri an Italian company first brought the idea of selling bottled water in India. In the same year, Bisleri set up a bottling plant for manufacturing and marketing its mineral water but failed. The brand was later sold off to Parle in 1968-69. Parle Group acquired the Bisleri brand with the intent of launching Soda Water but later also launched bottled water.

The launch was a big flop, as the Indian public did not accept concept of buying water, that too in bottled form. During the initial days, Bisleri packaged drinking water was available in glass bottles. In 1972-73, Bisleri was made available in unbreakable, non-returnable PVC (Poly Vinyl Chloride) bottles. Things began to change a little, even though the market remained dormant for quite long (for a period of about 20 years). During this period, the bottled water market was

primarily restricted to 5-Star hotels and other such premium institutions that catered to foreign tourists and upper classes.

During this period, Parle Products Limited, the company that owned Bisleri had become a virtual monopoly in the Indian soft drinks market with its three big brands – Gold Spot, Thums Up and Limca. With the re-entry of Pepsi and Coca Cola into India in the early 1990s, Parle sold off all the brands to Coca Cola at a heavy premium. When Coca Cola bought Parle's bestseller brands, it also obtained the rights to market Bisleri brand of soda for five years.

Bisleri bottled water was re-launched by Parle in 1998. By this time, with expansion of media and exposure to international life styles, deteriorating levels of potable water, increase in the number of water borne diseases, and awareness about health and hygiene, led to acceptability of concept of mineral water. In 1998 when the Bisleri brand reverted back to Parle from Coca Cola, Chauhan began focusing his attention to building the brand as a synonym for mineral water. For the five years that Bisleri was with Coca Cola, Chauhan remarked, *"I was more or less unemployed, and doing the donkey's work of bottling for Coca Cola"*.<sup>80</sup> With Bisleri, Chauhan quoted, "we had a brand name, we had a product, but we had no facility as such, be it bottling plants, be it distribution network or other infrastructure."

Parle claims that Bisleri grew by 80 per cent in 1998-1999 and by 150 per cent in 2000.<sup>81</sup> During this period, the industry was so attractive that it attracted a host of National, regional and local players. The launch of the half-liter (500ml) bottle led to a dramatic rise in volumes and business prospects for Bisleri, prompting Parle to try and consider expanding into different pack sizes, sub 1-liter packs and bulk packs. By this time, Bisleri had already become a generic for mineral water in India.

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<sup>80</sup> *"Ninja Extraordinaire."* Business Standard, August 2001

<sup>81</sup> *"Ninja Extraordinaire."* Business Standard, August 2001



## **Bottled Water in India - The Growth Drivers**

One of the major growth drivers for the bottled water industry is the increasing health consciousness among the Indians, mainly due to increased literacy levels. Mineral water used to be an elitist indulgence or something to do with health, but with growing water scarcity in the cities of India, it has become the only safe source of drinking water.

One of the major problems faced by rural Indians is the lack of pure drinking water. Despite targeted government programmes such as the Accelerated Rural Water Supply Programme (ARWSP), 16,332 habitations (hamlets) completely lack connectivity on the waterfront. Another 132,183 habitations are only partially covered, presenting a huge opportunity for the bottled water industry.

There has been a significant increase in the purchasing power in urban India over the years. Bottled water has since become affordable to a much larger segment of urban India. Moreover, with increased thrust on health and tourism, the consumption of mineral water is only expected to increase further.

In rural as well as urban India, mineral water has also become a norm during marriages and other functions. It is consumed not only as a hygienic source of water, but is also seen as a status symbol these days. The trend was started by Bisleri, which initially distributed bottled water free of cost in the rural areas on festive occasions, in order to initiate the villagers to bottled water as well as to build relationships.

Another social factor driving the growth of the mineral water industry in India is the proliferation of the railways and roadways traffic. Since there are few public sources of fresh

drinking water available in our country, most travelers prefer to carry a mineral water bottle during their journey.

### **Categorization of the Indian Bottled Water Industry<sup>82</sup>**

The bottled water market in India is crowded with a large number of players in both the organized and unorganized sectors, and price is an important deciding factor for a purchase decision by consumers.

The industry initially comprised of only one SKU of 1 litre. This was followed a by a number of smaller and bigger SKUs.

- *Retail consumption market* – The traveling populace of the country form the major portion of the Retail Consumption market. The most consumed SKUs in this market category are the 500 ml and the 1 liter ones. The main competitors for the retail segment are the soft drink industry as well as the concentrated drinks industry.
- *Household and Institutional consumption market* – The hotel industry, caterers, offices, parties, travel, tourism, hospitals etc largely constitute the institutional market. The SKUs that are available in this market are 10 liters and above besides this we have pack size of 250ml plastic cups. The main competitors for the institutional segment are the water purifier industry as well as the concentrated drinks industry.

Each of these consumption markets has a number of SKUs under it. Some of the most consumed SKUs in retail market are 500ml, 1 litre, 1.5 litres, 2 litres, 5 litres and 20 litres.

The market can also be categorized on the basis of the price at which this bottled water is available into three categories.

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<sup>82</sup> [www.indiainfoline.com](http://www.indiainfoline.com)

- Super premium mineral water
- Premium local natural mineral water
- Popular or plain bottled water

Presently, Evian of Danone group and Perrier and San-Pellegrino of Nestle belong to super premium category; Catch, Himalayan, Brilliant etc. belong to premium local natural mineral water category; and all other brands like Bisleri, Bailley (both from Parle), Kinley (of Coca Cola), Aquafina (of Pepsi) etc. belong to popular or plain bottled water category.

### **The Battle Royalé for Indian Bottled Water Market**

The bottled water market for the past three years, on an average, has been growing at unimaginable rates of close to 40-45% and this could be explained on account of the lower base of previous years.<sup>83</sup> It is witnessing a launch of new brands by a number of regional players and has more than 250 players in the fray currently.<sup>84</sup> Besides these there are a number of fly-by-night operators who enter the market in summers, reap benefits by packaging tap water and selling as pure mineral water, and then exit the market once the season is over. These companies take full advantage of the low awareness levels and brand consciousness amongst unassuming consumers by selling simple tap water as mineral water. The government has also not been very effective in setting and enforcing the norms in the industry.

The total Indian bottled water market is estimated to be Rs.11-12 billion, of which, around Rs.7 billion is in the hands of organized sector and rest is with unorganized sector. With shifting consumer preference from carbonated drinks towards bottled water, the growth rate is

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<sup>83</sup> “*Bold and Bisleri.*” Hindu Business Line, Apr 25, 2002

<sup>84</sup> “*Will water find its mark?*” Business Line – Catalyst, January 18, 2001

expected to stabilize at 25-30 % for next 4-5 years.<sup>85</sup> This strong growth rate of the industry has attracted a number of global players like Coca Cola, PepsiCo, Nestle, to launch their products in the market. Many more like Britannia and Hindustan Lever Limited (the Indian subsidiary of Unilever, PLC.) have evinced interest in the market.

### ***Competition***

The bottled water industry effectively competes with both the water-purifiers as well as the soft drinks industry. The water purifier industry (primarily the Aqua Guard brand of the Eureka Forbes) is credited to have done the spadework for creating the safety and health consciousness in water consumption, and is a serious competitor in the household and institutional consumption market, whereas the soft drinks industry is a strong competitor in the retail consumption market.

### **Coca-Cola<sup>86</sup>**

The company had entered the business in May 2000 through its extending its soda water brand, Kinley. The company has tied up with Kothari Beverages, of Yes brand of mineral water, for manufacturing Kinley bottled water at Yes' facilities. The brand is available in pack sizes of 500 ml, 1-litre, 1.5-litre, 2-litre, 5-litre, 20-litre and 25-litre. While the Kinley 500-ml bottle is priced at Rs 6, the 2-litre bottle is available for Rs 17. With the growing market, Coca-Cola is planning to scale up its bottling capacity, up from the 15 existing plants. Coca Cola has identified 10 to 15 sites for additional plants for setting up a combination of company-owned plants, franchisee operations and contract packers.

### **PepsiCo<sup>87</sup>**

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<sup>85</sup> www.indiainfoline.com

<sup>86</sup> "Bold and Bisleri." Hindu Business Line, Apr 25, 2002

<sup>87</sup> "Pepsi, Nestle take the plunge into bottled water -- Britannia waits in the wings." Hindu Business Line, June 21, 2000

The company entered the bottled water business in September 1999 under the Aquafina brand. The company began by targeting its product towards the youth with a 750-ml pack. It now retails in conventional retail pack sizes of 500-ml and 1-litre bottles. The brand has the strong backing of a distribution channel of 60,000 outlet and the refrigerators at Pepsi's retail outlets, which stock its cold drinks. Though the company is present only in selected market as of now, it has plans of increasing share in the market by expanding its SKUs portfolio as well as its distribution reach. Sources say PepsiCo India has been investing in additional capacity at its plants in Bangalore and Chennai for the bulk water foray.

### **Bailey<sup>88</sup>**

The brand is a product of Parle Agro, the company that launched Frooti (mango drink in tetrapacks). Bailey is credited with creating a new segment of 330ml SKU (the right quantity to quench the thirst of an adult!) in the market.

### **Nestle<sup>89</sup>**

Multinational Nestle has already started making forays into the bottled water industry with its brand Pure Life. Nestle is a big player in the mineral water market internationally, with brands like Perrier and San Pellegrino in its stable. Nestle has set-up two bottling plants in Mumbai and New Delhi, to service the markets in these regions. It plans initially to tap only the huge market for bottled water in large cities and towns.

### **Others**

Britannia at present distributes Evian and will launch its own branded water very soon. The National Dairy Development Board also plans to launch Dhara through its distribution chain. New entrants Atco with Brilliant water and DS Foods with Catch spring water are positioned

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<sup>88</sup> [www.indiainfoline.com](http://www.indiainfoline.com)

<sup>89</sup> "Big players keen to get into bottled water." The Hindu, February 18, 2001

on the mineral water plank.<sup>90</sup> Another player with technical expertise is Thermax, in a joint venture with US-based Culligan Water Technologies. Largely into industrial water purification, Thermax Culligan recently announced its entry into the household segment with the launch of 20-litre packs of drinking water, branded Good Water, at Rs 60 a pack.<sup>91</sup>

Apart from these are the small players, which, according to industry sources, cater to nearly as big a market as the big players. Among these the prominent ones are: Indian Railways' Rail Neer, Godrej's Golden Valley in the South, Amrit Agro's Amrit Aqua, Kothari Foods' Yes and T-Series' Ganga in the North and SM Dyechem's Peppy in the West.<sup>92</sup>

### ***Bisleri wins the Battle Royalé – Phase I***

According to Mr. Ramesh Chauhan, Chairman, Parle Bisleri, "The success of bottled water could be attributed to two factors. First, it has been an underdeveloped business for a while now, and, second, soft drink manufacturers have priced themselves out by a long shot. The prices of soft drinks have, in fact, doubled in the last ten years and this has happened because the price of concentrates has shot up during this period."<sup>93</sup>

Bisleri, till February 2002, was the market leader and controlled 37.6% (drastically down from 59.9% in 2000) of the market followed by Cola-Cola's Kinley with a market share of 28.2% (up from 8-9% in 2000) and PepsiCo's Aquafina controlling 11.1% (3.6% in 2000). Prakash Chauhan promoted Bailey's share had also increased in 2002 to 5.7% from

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<sup>90</sup> "Pepsi, Nestle take the plunge into bottled water -- Britannia waits in the wings." Hindu Business Line, June 21, 2000

<sup>91</sup> "Water wars – Bulk Water Market." www.domainb-school.com, 29 January 2003

<sup>92</sup> "MNCs Gain Ground in Branded Water." Yahoo India, April 24, 2002.  
URL: <http://www.corpwatchindia.org/news/PND.jsp?articleid=1524>

<sup>93</sup> "Big players keen to get into bottled water." The Hindu, February 18, 2001

5.3% in 2000. Rest of the organized market is well distributed among small regional players.<sup>94</sup>

According to ORG-MARG retail audit data for the month ended March 2003, Kinley's market-share stood at 34 per cent as against 29.8 per cent in March 2002, followed by PepsiCo India's Aquafina with a 12 per cent as against its 11.5 per cent share during the same period last year.<sup>95</sup> The only brand whose market share slipped in March 2003 was Bisleri with a 35 per cent share as against 37.6 per cent share in March 2002, even though it was slightly up from 34.4% of July 2002, a figure refuted by Ramesh Chauhan. It is apparent that Bisleri is clearly losing ground to other major brands. So the question is – Should Chauhan sell off the brand while it retains the advantage of being the market leader?

### **Bisleri's Domestic Strategy**

In such a competitive market one would expect a clear differentiation among the water brands in terms of both pricing and positioning. While Bisleri touts itself as “pure and safe,” brands like Bailey, Yes, and Hello are trying to ride the mineral water wave. Evian, launched by French transnational Danone sells as “water from the French Alps” competing with premium soft drinks. The fact however remains that almost all players in this category are positioning themselves on the purity and hygiene platforms, since the basis of success of bottled drinking water is the poor quality of public tap water in India. It has therefore, become increasingly difficult to differentiate Bisleri and Bisleri's ability to maintain its market leadership is under question.

### ***Packaging***

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<sup>94</sup> “Competition hots up in bottled water business.” The Hindu, September 26, 2002

<sup>95</sup> “*Public Memory Can Be Short.*” The Financial Express, August, 16, 2003

Almost 76% of consumption of bottled drinking water happens during transit. Market research conducted by Bisleri revealed that the overriding concern for this set of buyers is the tampering of the seal and the reuse of bottles. Cases of bottles being refilled at railway stations with tap water have been reported. So when a consumer buys bottled water, he would like to be assured that the water has not been tampered with. Parle has differentiated Bisleri by its unique, breakaway seal as an assurance of purity.

Currently, Parle is pursuing a multi-pack and multi-price strategy. Today Bisleri offers 7 packaging options; a 250-ml cup and bottles in 500 ml, 1-litre, 2-litre, 5-litre, 10-litre and 20-litre packs. The 1-litre bottle accounts for nearly 50 per cent of the sales, with the 2-litre bottle taking up 20 per cent of the sales.<sup>96</sup> The 500-ml pack priced at Rs 5, and the 250-ml cups priced at Rs 3, have spearheaded Bisleri's growth in the recent years. Chauhan believes that "real growth can only come from the home segment and if we can rake the home segment we think we'll have hit the jackpot." The company has introduced home delivery for its 20-litre pack (priced at Rs 70).<sup>97</sup>

Also research revealed that there was a lot of spurious activity in the 20-litre segment. The rates of imitation were as high as one spurious bottle for every original Bisleri pack. Thereafter, Bisleri re-launched the 20-litre packs with a foolproof cap for the large bottles.<sup>98</sup>

Recent packaging firsts for Bisleri have been the breakaway seal, hexagonal 20-litre jars, pouring spouts and jars with dispensers which do away with the need to lift the jars while pouring out water. Recently Bisleri also announced the re-launch of its 20-litre home pack with a more "consumer-friendly format" in thread fitting and valve cap, against the conventional snap-on fittings.

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<sup>96</sup> [www.bislerimineralwater.com](http://www.bislerimineralwater.com)

<sup>97</sup> "Parle Bisleri mulls IPO to fund spread." Business-Standard, Mar 12 2001

<sup>98</sup> "Bisleri pitches 20-lt pack to take on colas." Business Line – Catalyst, July 11, 2001



## *Segmentation*

Not only does Parle plan to make the basic pack-sizes available all over the country, it has also decided to create greater variety in packaging. Bisleri has a 5 litre pack targeting homes while the 20 litre pack is being targeted at offices and commercial outfits. To strengthen its presence here, Bisleri is investing heavily on vans, since distribution is a key factor in the business, especially when competing with firms like Coca Cola and Pepsi, who would leverage their distribution and retail networks established for their soft drinks business.

Parle's strategy to break into the home segment is clear-cut: "Be a service-oriented delivery player or just be out of it." The exercise was kick-started from Mumbai, in February 2001 with a unique initiative wherein 20 trucks-dedicated for home delivery were designed as "Bisleri Homes." A replica of a simple house with a concrete roof, chimney, doors and other paraphernalia associated with a normal house, these trucks were taken door-to-door in some select localities. The home segment was targeted with a pack size of 5 litres aggressively priced at Rs 25. The idea was to have high visibility in the home segment and enter the housewife's minds.<sup>99</sup>

It was also estimated that four years down the line, almost 75% of the sales would come from bulk packs of 5 to 20 litres. The two accounted for less than 20% of sales, in 2001 and close to 40% of packaged drinking water consumption happened on premises, which includes eateries, homes, restaurants etc. Large shops and commercial complexes are fast emerging as strong potential for packaged drinking water marketers and Bisleri wants to establish itself here.<sup>100</sup>

## *Operations*

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<sup>99</sup> "Bisleri's growth strategy -- Tap home segment." Financial Express, December 27, 2000

<sup>100</sup> "Success in bulk." Strategist, Business Standard, August 2000

In 2001, the company had 25 bottling units with a bottling capacity of 50 million cases per day. The company owned over 80 % of these bottling operations,<sup>101</sup> in order to ensure quality. This also ensures the company against the threat of being thrown out of the market due to its bottler being bought out by a competitor, just as it happened in Kolkata in 2001, when Bisleri was absent from the market for six months due to its bottler being bought up by Coca Cola.

When Bisleri started brand building in 1994-1995, it concentrated on the water business, and didn't do anything about making the plastic containers, caps, etc. It was only in 1998 that the company started concentrating on the entire value chain and bought plastic bottle-making machines and other machines. Now it manufactures what is called the sport cap, which pops up and down the bottle-top. This also ensures high quality of packing materials; components like caps and bottles are manufactured in-house from resins of quality suppliers.

### ***Advertising***

Bisleri is promoted by an aggressive print-and-TV backed by hoardings and point-of-sale material. Since two of the biggest concerns of a consumer while purchasing bottled water are safety aspect of bottled water and spurious brands, the safety and hard-to-duplicate factors are highlighted in every Bisleri advertisement. Every interface with the consumer is being used as an opportunity to reinforce the message. For instance, all vehicles used for supply have been painted in bright blue, bear the Bisleri logo and sport catchy baselines like 'drink and drive'.

### ***Distribution System***

Apart from creating consumer pull with an advertising campaign, Parle is boosting the retail push as well. Distribution is the key to a successful bottled water brand. The consumer is

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<sup>101</sup> "Parle Bisleri mulls IPO to fund spread." Business-Standard, Mar 12 2001

expected to pick up whatever is conveniently available and is pushed by the retailer, since the prime need for the consumer is the *safest available* source of water, and the need is such that it cannot be put-off for long. As Mr. Chauhan says, “Just about anybody can invest money into a bottling plant or other facilities. The really dirty work is distribution. Making fresh water available within a particular period of time is crucial for its success.”

Bisleri’s retail distribution muscle is worth appreciating. The company currently has a fleet of over 2,000 vehicles servicing 120,000 retail outlets spread across the country. The company is targeting a distribution network of 10 lakh<sup>102</sup> retail outlets backed by a fleet of about 5,000 vehicles over the next couple of years.<sup>103</sup>

Parle leverages its large fleet of trucks to supply bottled water directly to retailers through a system called ‘*route selling*’ where the driver of the truck is trained to be a service person. A critical component ensures that the water supplied is fresh and bottles are in good shape. The route selling, while very effective, is far more expensive than the more commonly followed method of appointing distributors in different towns.

### ***Pricing***

The bottled water market in India is crowded with a large number of players in both the organized and unorganized sectors, and price is an important deciding factor for a purchase decision by consumers.

Bisleri is priced to benefit volume purchase, for instance while the 1-litre bottle is priced at Rs 10, the 2-litre bottle is priced at Rs 15 (Rs 7.50 per litre), the 5-litre pack at Rs 20 (Rs. 4

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<sup>102</sup> One lakh = 100,000.

<sup>103</sup> “Bisleri to have own distribution network.” Hindu Business Line, April 05, 2000

per litre) and the 20-litre pack at 70 (Rs 3.50 per litre).<sup>104</sup> The motive behind rationalizing the prices of 20 and 5 litre jars is to transfer the value generated on the distribution of bulk packs to the customers.

Parle is planning to further bring down the prices for Bisleri. This is totally in contradiction to the strategy of its major competitors, as Coca-Cola is hiking the price of its popular one-litre Kinley bottle from Rs 10 to Rs 12, bringing it at par with Pepsi's Aquafina. Such an aggressive pricing strategy on part of Bisleri has been a complete enigma to its competitors, the spokesperson of one of them remarking, "We don't know how Mr. Chauhan continues to sell Bisleri at this price!"<sup>105</sup>

### ***Sourcing***

Purity and safety are two major factors in sourcing and processing of Bisleri water. The underground spring is carefully selected based on its portability and pathogen free water. Great care goes in tapping this source and water only water below 25 meters is tapped, in order to avoid any surface contamination to percolate and mix with underground water source. Area surrounding the water collection tube at the surface is protected and kept clean.

### ***Processing and Quality Assurance***<sup>106</sup>

To ensure Bisleri is safe and free from contamination, ultraviolet treatment and ozonisation processes are carried out. The sterilization effect of ozonised water continues even after water is packaged, thereby ensuring safety of Bisleri right from sourcing, to its final packing: the casing tube at the source itself is protected with stainless steel mesh to give a preliminary filtration to

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<sup>104</sup> "Bisleri launches direct home delivery of its 20 litre pack." The Strategist, Business Standard, Aug 2000

<sup>105</sup> "Will water find its mark?" Business Line – Catalyst, January 18, 2001

<sup>106</sup> [www.bislerimineralwater.com](http://www.bislerimineralwater.com)

the water; ultra filtration gives water reduction in turbidity and adds sparkle; activated carbon purifier removes color and odour in water; and reverse osmosis (through membrane of porosity less than 0.01 microns), renders the water free of micro-organisms and dissolved solids.

Good Manufacturing Practices are stringently followed at all times. Processing is religiously monitored at every stage. Testing source water, processing parameters, microbial quality, packaging material integrity and finally, shelf life studies form an integral part of quality and safety assurance plan.

### **Bisleri – Gearing up for the Future Challenges**

#### ***The Legal-Political Environment***

The Union Health Ministry (Government of India) has recently started taking immense interest in the quality of mineral water distributed in India. There has been an exercise on the part of Government of India to force the Indian mineral water players to meet the European norms on pesticide concentration in their bottled water. The Centre for Science and Environment (CSE) has also found major packaged water brands with pesticides above acceptable levels as per the EU standards.

While PepsiCo and Coca Cola claimed that their respective brands, Aquafina and Kinley met the European standards, Catch claimed that it met both the U.S. and the European standards. Bisleri, however, challenged the findings of CSE, claiming that there were no facilities available in India to find out if a brand meets EU norms. Further, they claimed that no country in the world adheres to EU norms on pesticides. However, according to a company release, the Central Food and Technology Research Institute (CFTRI), Mysore, have tested the brand on European Standards, the findings of the institute indicate, “not detected” for all pesticides specified.

Refuting all the claims, the Government of India (GoI) cracked down on the manufacturing facilities of various top players including PepsiCo and Bisleri. It further pulled out the ISI quality marking (the quality standard conferred by the Bureau of Indian Standards) and issued stern warning letters. The action was taken on the basis of raids conducted by various regional arms of the Bureau of Industrial Standards (BIS). The license of Bisleri was cancelled by the GoI, but was restored at a later date. Six months after the CSE report on water came in; the ministry recently issued a fresh deadline for enforcement of stringent norms on pesticide content in packaged water. The new safety and quality norms for packaged bottled water will become effective from January 1, 2004. However, it is not known how many large or small players have followed the new standards as yet.<sup>107</sup>

This action of the Government is expected to have serious repercussions for the bottled water players. While on the one hand, it is likely to have adverse repercussions on consumer trust posed in the brands, some of the smaller players have already started fearing a fate similar to the small Indian cold drink manufacturers, after the entry of the international players, when claims that Indian cold drinks contained the carcinogenic beverage vegetable oils forced them out of the market.

A section of industry watchers expects that the stricter controls regimes would see an industry shake out, leading to the exit of smaller and unorganized players. However, there is another school of thought, which says the mandatory BIS certification would not effect major changes on the market scenario, for stringent provisions have been laid out in the existing Prevention of Food Adulteration Act (PFA). The latest retail audit data given by ORG-MARG (a leading Market Research firm in India) for the month ended March 2003 corroborates this.

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<sup>107</sup> *“Public Memory Can Be Short.”* The Financial Express, August, 16, 2003

Bisleri's sales grew 50% since February 4, 2003, when the report was published. Pepsi's Aquafina sales surged 75% during the period, while sales of Coca-Cola's Kinley grew 25-30% despite a 20% hike in prices. Meanwhile, brands that were found conforming to prescribed European norms have also reported a significant jump in sale volumes in the past six months.<sup>108</sup>

Another notification of the Bureau of Industrial Standards dated February 28, 2001 allowed only the following packaged sizes: 100 ml, 150 ml, 200 ml, 250 ml, 300 ml, 330 ml (in cans), 500 ml, 750 ml, 1 litre, 1.5 litres, 2/3/4/5 litres; and thereafter in multiples of five litres. The notification, which covers the following four categories: aerated soft drinks, non-alcoholic beverages, mineral water and drinking water, came into effect on March 29, 2001. The flip side of this notification is that the 330-ml and 1.2-litre packages, which target people on the move, and the 12-litre and 24-litre jerry cans, which are popular in the home segment, will subsequently be "outlawed".<sup>109</sup>

While the 12-litre cans are popular in the southern market, the 18 and 24-litre cans are popular in the home segment in all the metros, according to industry representatives. And directly in the line of fire are brands such as 'Chhotu Bailey', Bisleri, Prime, Hello and Apollo, to name a handful. Bisleri stands to lose the 20 crores it had spent on the marketing of Chhotu Bisleri, its 1.2 liter pack at the price of the one liter pack.

### ***Increasing reach through New Plants and Packaging***

"Carbonated soft-drinks are the past. The future is with water,"<sup>110</sup> says Mr. Ramesh Chauhan, barely nonplussed by the aggressive foray of Cola-majors, Pepsi and Coca Cola, and food MNCs such as Nestle into the packaged water segment. With the level of 25 plants bottling

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<sup>108</sup> "Public Memory Can Be Short." The Financial Express, August, 16, 2003

<sup>109</sup> "New bottled water rule has industry gulping." Hindu Business Line, March 27, 2001

<sup>110</sup> "Bisleri pitches 20-lt pack to take on colas." Business Line – Catalyst, July 11, 2001

50 million cases per day in 2001, Parle has planned an investment of Rs 260 crores<sup>111</sup> for expanding its facilities including its bottling capacity and distribution network. Out of this investment, Rs 60 crore were to be invested on expanding the bottling capacity to 50 million cases (from its existing 25 bottling units) to 200 million cases (from a targeted 55 bottling units) a day and the remaining Rs 200 crore was planned to rake up Bisleri's distribution network spanning 2,500 towns and cities in India.<sup>112</sup> It has put up a new plant in Bangalore and in another 18 months Parle plans to set up greenfield plants in Hyderabad, Pune and Ahmedabad, besides expanding the capacity in Kolkata. The real hurdle in this expansion, as quoted by the management is land acquisition.<sup>113</sup>

Ever since the Centre for Science and Environment (CSE) study reporting that the major bottled water brands were found to be contaminated, Bisleri has been trying to convey a quality sensitive image to the consumers. Recently Bisleri has introduced the process of blowing its own bottles and filling it up at one unit only, to avoid any contamination. It has plans to extend this facility to its other units as well.

Bisleri intends to penetrate every possible segment of the market by introducing more pack sizes and establishing the brand strongly with trendy new packaging, supported by an ad budget that's risen six-fold over the last year.

### ***Waste Recycling***

Bisleri has started planning for the process of recycling its bottles for manufacturing different products. Under the plan, Bisleri will collect the bottles from various places, crush them and cart

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<sup>111</sup> One Crore = 10,000,000 (ten millions)

<sup>112</sup> "Parle Bisleri mulls IPO to fund spread." Business-Standard, Mar 12 2001

<sup>113</sup> "Bisleri pitches 20-lt pack to take on colas." Business Line – Catalyst, July 11, 2001



them back to its manufacturing unit where the pieces will be shredded and made into either ropes or other products.

### ***Use of Technology in Selling***

The latest initiative being sought for by Bisleri is to receive sales order over the Internet. This industry is marked by little differentiation between the brands, and this initiative is expected to give Bisleri the critical competitive edge.

### ***Grooming Bisleri for International Market***

When Parle sold Maaza (a mango-flavored drink) to Coca-Cola India, it retained the rights to produce and market the mango drink in the US. The US-based group company, Maaza Beverages, has entered into a strategic tie-up with an existing bottler in France for distribution of Bisleri in the US. The French company will bottle the water under the Bisleri brand and the bottled water shall be marketed and distributed by Maaza beverages in the USA. The company is hoping to reap two advantages by this strategy. One, it is hoping to play down the sub-quality image perception of Indian goods by the U.S. consumers. US laws stipulate that a foreign water brand must establish its usage first before being licensed. Parle has already exported Bisleri samples to the US to establish the fact that an active population is consuming the water. Second, by co-distributing Bisleri with Maaza, the company is hoping that Bisleri's foray into the US will even out the distribution costs of Maaza.

Industry experts see Bisleri's international foray against the backdrop of the company's game-plan to rope in a foreign partner. According to one industry expert, Bisleri is trying to get its act together before it can actually attract a foreign buyer. *"This European launch will silence*

*critics, who had raised issues concerning Bisleri's water quality. The company stands proud by its high international quality and has the confidence to take the European market by storm,"* a company release said.<sup>114</sup> Bisleri is closing down defunct companies and merging the active ones. It has also decided to name the merged entity, Bisleri International. The company hopes to project its quality image through the international launch.

According to Mr. Chauhan, "The fact that we have reached out to international markets is an acknowledgement of our quality and our penchant for safety and purity". For the European market, Bisleri will be bottled in three sizes of 500 ml, 750 ml and 1.5 litre bottles at its operations in Jandun, France. Every year 3.1 billion containers will be filled, one of the highest demands ever for Bisleri.<sup>115</sup>

### **Concluding comments**

Even though the unimaginable growth rates of more than 60% and even 100% can be explained due to lower base the present growth rate of 25-30% is sustainable for another 5-6 years. Today the demand of bottled water is increasing at a much higher rate than that of carbonated soft drinks. The market size of bottled water too is expected to surpass the size of soft drinks market in near future.<sup>116</sup>

The existing players will have to expand their distribution network to have their presence across the country. The market is also expected to undergo a major consolidation phase. As one of the major factors important for success in the market is the distribution network, firms with deep pockets are expected to acquire existing small regional players in order to spread their network across the country.

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<sup>114</sup> "Bisleri Set To Tap Global Markets." The Financial Express, September 04, 2003

<sup>115</sup> "Bisleri Set To Tap Global Markets." The Financial Express, September 04, 2003

<sup>116</sup> [www.indiaonline.com](http://www.indiaonline.com)

Already Coca Cola has tied up with Yes for manufacturing of its brands in areas where it does not have presence. Since Coca Cola and Pepsi both have a well-established distribution network as well as bottling and manufacturing plants, they seem to be at an advantage. But players like HLL and Nestle with strong financial muscle can easily turn the tables in their favour through the acquisition route. Bisleri is aware of the lurking threat of the multinationals, Coca Cola, Pepsi, Nestle, etc., who were keen on raising their stakes in the Rs 7 billion, 700 million-litre market, which had grown by 70 per cent last year.<sup>117</sup> It now wonders what new initiatives can be taken to sustain the aura that had made Bisleri the generic name for mineral water in the country. As the rain plattered down, Chauhan's thoughts further strayed to wondering how long he could keep fighting the multinationals single handedly, and whether he should sell off his last remaining brand to some MNC heavyweight. The future of Bisleri was at stake!

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<sup>117</sup> "*Mineral water is where the action is.*" [www.rediff.com](http://www.rediff.com), August 25, 2000

## **Bisleri: Muddling through Choppy Waters**

Teaching Note<sup>118</sup>

### ***Case Abstract***

Bisleri is aware of the lurking threat of the multinationals, Coca Cola, Pepsi, Nestle etc. who were keen on raising their stakes in the Rs 7 billion, 700 million-litre market, which had grown by 70 per cent last year. It now wonders what new initiatives can be taken to sustain the aura that had made Bisleri the generic name for mineral water in India. In this backdrop, the chairman of Bisleri Mr. Ramesh Chauhan is perplexed as to how long he could keep fighting the multinationals single handedly, and whether he should sell off his last remaining brand to some MNC heavyweight.

### ***Teaching Objectives***

- To present differentiation strategies for low involvement products with little differences between competing brands.
- To demonstrate the modus operandi to stave of the challenge of brands offered by bigger and diversified companies, with a special focus on the context of Indian business competing with MNCs in India.
- To explain the essential needs of an exit strategy:
  - What should be the timing of exit?

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<sup>118</sup> Teaching note written by Prof. R Srinivasan, Indian Institute of Management Lucknow with support from Rahul Gupta and Bharat Agarwal, PGDM (2004) students, to be used with the case, "Bisleri: Muddling through choppy waters," IIML Case Series: 2003-13. © 2004. Prof. R Srinivasan, Indian Institute of Management Lucknow.

- What steps may be performed before exiting (selling-off) a brand, in order to get the best possible returns from nurturing the brand?

***Courses, levels, and topics for which the case is intended***

*Courses*

Post Graduate courses in Management, primarily in the fields of Marketing Management and Strategic Marketing.

*Levels*

Year-1 Compulsory course in Marketing Management

Year-2 Compulsory/ Elective course in Strategic Marketing

*Topics*

Marketing Management

- Differentiation strategy
- Exit Strategies

Strategic Marketing

- Environmental Analysis
- Branding strategies in the context of a changing macroeconomic environment

***Classroom Discussion Questions***

Marketing Management

Q1. What strategies may be adopted by brands (in the low involvement product category) to differentiate themselves in product lines where the scope of differentiation is low?

Answer:

- Low involvement product category with few differences between brands in a classic case of Habitual Buying Behavior (Ansoff Product Market Matrix).
- The consumers do not search extensively for information, evaluate characteristics, and make a decision. Instead, they are passive recipients of information in television and print media. The consumers go to the store and reach out for the brand, if they keep reaching for the same brand, it is out of habit, and so much out of strong brand loyalty.
- Marketers of such products find it effective to use price and sales promotions to stimulate product trial. Television advertising is more effective than print because it is a low involvement medium that is suitable for passive learning.
- To support the pull factors, companies focus on strengthening their distribution networks to ensure deeper reach and a regular and timely availability of their brands.
- Also as customers reach for the ‘most visible’ brand at the store, marketers use point-of-purchase material to create visibility.

Q2. Discuss the differentiation strategies specific to Mineral Water industry (Bisleri’s Strategy).

Answer:

- Differentiation is a process of adding a set of meaningful and valued differences to distinguish the company’s offering from competitor’s offerings.
- Parle has been trying to differentiate Bisleri by its breakaway seal as an assurance of purity.
- Parle is pursuing a multi-pack and multi-price strategy. Today Bisleri offers 7 packaging options; a 250-ml cup and bottles in 500 ml, 1-litre, 2-litre, 5-litre, 10-litre and 20-litre packs.

The Company's one-litre range accounts for 50 per cent of the turnover and the 500-ml pack, priced at Rs 5, has spearheaded Bisleri's growth.

- Bisleri is priced to benefit volume purchase, for instance while the 1-litre bottle is priced at Rs 10, the 2-litre bottle is priced at Rs 15 (Rs 7.50 per litre), the 5-litre pack at Rs 20 (Rs. 4 per litre) and the 20-litre pack at 70 (Rs 3.50 per litre)
- The company owns over 80 per cent of its bottling operations, another strategy to ensure quality.
- Distribution: Unlike other consumer goods companies, Bisleri has been present in the rural areas for over 20 years now. They have a fleet of 2000 trucks and 500 distributors trying to ensure Bisleri's availability throughout the country. However, maintaining such a vast distribution network also adds to the costs, and has hence forced Bisleri to look for a strategic partner to co-distribute.

Q3. What strategies can brands use to build loyalty for themselves in areas where they have little or no reach? How can brands overcome the challenge of competitors when they do not have the finances to maintain a vast distribution network?

Answer:

- Brands in the low involvement product category with little or no significant differences exist between brands generally use image differentiation to distinguish their brands from competitors and build loyalty.
- Bisleri is promoted by an aggressive print-and-TV backed by hoardings and point-of-sale material. Since two of the biggest concerns of a consumer while purchasing bottled water are safety of bottled water and duplicity of brands, the safety and hard-to-duplicate factors are

highlighted in every Bisleri advertisement. Every interface with the consumer is being used as an opportunity to reinforce the message.

- This has helped Parle to establish the Bisleri's character and value proposition as a 'safe' drinking water.

Q4. Discuss what steps should be taken by brand owners to enhance the value perception of the brand before selling it off? What can be said to be the ideal timing for selling off a particular brand?

Answer (**Ideal time for exiting a particular brand**)

- Bisleri was once the generic for Mineral Water in India, with people referring to mineral water as 'Bisleri'.
- It held most of the rural Indian market and a lion's share of the urban market as well.
- Under these circumstances, multiple offers were made to Chauhan to sell off his last sustaining brand Bisleri; he had to sell-off his soft drink brands much in advance under pressure from Coca Cola and Pepsi and he was then offered a very hefty price.
- The fiduciary relationship that Chauhan had with Bisleri, forced him to take a myopic view of circumstances and refrained him from selling-off Bisleri then and there to players like Nestle or Unilever.
- However, it is also argued that this strategy of Chauhan holds an even greater promise for him, as currently Bisleri is foraying into the international markets, selling-off all defunct businesses and merging the active ones under the name Bisleri International; thus fetching Chauhan an all-time high value for Bisleri.



## Strategic Marketing

Q5. Discuss the Internationalization strategy of Bisleri in the light of consumer perception and evolving domestic environment. What are Bisleri's strategies in the light of international competition?

Answer:

- *Political Factors*
  - Government turns on the heat:
  - Study by NGO - Centre for Science and Environment (CSE) - revealed bottled water contained a "cocktail of pesticide residue."
  - Proposed – Bottled water to meet EU standards for pesticide residue
  - Mandatory for manufacturers to produce a NOC from the Central or State government ground water authorities to obtain license from BIS & PFA authorities
  - Apr, 02 - Bureau of Indian Standards (BIS) certification necessary
  - Feb, 01 – regulated pack sizes
- *Economic Factors*
  - Importance of Rural Markets
    - i. Slow pace of Accelerated Rural Water Supply Programme (ARWSP)
  - Urban markets
    - i. Greater affordability
    - ii. Thrust on tourism
- *Social Factors*

- Mineral water used to be an elitist indulgence primarily sold at hotels and hospitals
- Mineral water now is safe drinking water due to greater health consciousness, Statement of style and Status symbol (Rural)
- *Technological Factors*
  - Technology - Integrally related throughout the Value Chain (Inflating of bottles and manufacturing of caps to selling & distribution of bottled water)

Q6. Discuss Bisleri's Internationalization strategy in light of Chauhan's plan to sell off the brand to some International player?

Answer:

- Today's marketplace calls for an international outlook on business. Expansion into international markets offers several strategic advantages, one of which is that many corporations find that to compete effectively in the domestic markets, they must be willing to fight international competition on their home turf.
- The management at Bisleri realized that the brand has lost significant ground to competing brands in terms of market share and can no longer claim to be the unchallenged king of mineral water in India, as earlier. Few players would now be keen on buying out Bisleri (at the earlier offer price) unless it is offered to them as an internationally capable brand, with reach in Europe and America.
- Given this backdrop, Bisleri is trying to foray in the international market as its game plan to rope in a foreign partner and fetch the best possible value for the brand.

- The company is also closing down defunct companies and merging the active ones. It has also decided to name the merged entity, Bisleri International.
- Thus under its internationalization strategy, Bisleri has tried to shed all its notions of being a brand coming from a developing nation like India in order to avoid the perception of not being worth consumption among the International consumers. It got the mineral water bottled in France and with clear statements as “Bottled in France” has tried to engage the European and the American consumers.
- Further, Bisleri has tried to use the Maaza channel of distribution in order to become a low price player in the American market.

### *Epilogue*

The political environment in India has suddenly heated-up to the mineral water industry, with the major political parties joining forces to shut out sub-quality mineral water brands from India. However, the standards they want to apply to the mineral water industry are the European standards, which according to the major players, are not applied anywhere in the world, not even Europe! However, certain brands were banned from running their facilities for a short period in 2002-03, and after much hue and cry, were allowed to manufacture again. If the attitude of the Indian parliament remains belligerent to this extent, it might become difficult for the mineral water industry to sustain.

*The social backlash*, however, was not that strong, with major brands reporting a rise in sales throughout the period that controversy was in force. This could be attributed to two factors. One, that the Indian consumer has very few choices in terms of having pure drinking water, and in absence of alternatives, it did not react to the CSE study reporting the mineral water brands to

be unsafe. Secondly, the rise in sales can be attributed to the consumers concentrating on consuming major brands only, rather than a horde of other small, unorganized brands available in the market.

## **Dell Computer Corporation: Computer Hardware Industry**

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### **ABSTRACT**

The personal computer industry was changing more rapidly now than in the previous ten years. Despite slowdown in the economy, Dell Computer President, Paul Bell, was able to reassure investors that its' stock price would continue to yield profits. At a time when the computer market was showing signs of maturity, Dell was looking to make deeper investments into higher-margin and faster-growing server and storage segments. The main question to be resolved was how to differentiate Dell Computer Corporation from its' competition and achieve a winning edge over competitors within intensely competitive, rapidly changing immediate, intermediate, and long-term time frames.

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### **INTRODUCTION**

Speaking at International Data Corporation's (IDC), European Information Technology (IT) Forum, Paul Bell, president of Dell Computer Europe, the Middle East, and Africa, said consumers should keep buying. "We expect great bargains for a while. It was a great time to buy. Pricing feels less brutal to us because it still was a profitable business. You would continue to see massive amounts of innovation – if nothing else, in size: smaller and more portable. The personal computer (PC) was changing more rapidly now than in the previous ten years," Bell said [Evers, 2001]. Bell responded to Michael Capellas, Chair and CEO of Compaq Computer, who said in a crucial address that "brutal pricing" would last and "PC innovation would stagnate" [Evers, 2001]. Despite the slowdown in the economy Dell was able to reassure its investors (backing it up with the profits), that its stock price trading range was between \$15-\$31 throughout the year.

Dell Computer Corporation was a direct selling computer systems company. The company offered its customers a full range of computer systems, including desktop computers, notebook computers, workstations, network servers, and storage products, as well as an extended selection of peripheral hardware, computing software, and related/additional services. The company also offered a selection of services to support its customers' online projects (for example, premier pages through which the company offered paperless purchase orders, approved product configurations, global pricing, real-time order tracking, purchasing history and account team information). The company's direct selling model offered direct relationships with corporate and institutional customers, as well as telephone and Internet purchasing, customized computer systems, telephone and online technical support, and onsite product service. Dell sold its products and services to large corporations, small to medium-sized businesses, government, healthcare, and education customers, as well as individuals.

Cheaper component costs, slower demand, and competitive pressures all factored into a waves of price cuts, ranging from 20% to 31%, by three major PC makers on desktop models during 2001. Compaq slashed prices on one line of corporate desktop PCs by 31%. Hewlett-Packard cut prices on its business desktop PCs by as much as 28%. Dell dropped prices on its consumer desktop models by 20% [Business Week, 2001A]. Analysts and industry executives suggested that the PC industry could be in for a rebound by the end of 2001 or early 2002 due to several catalysts, including the new version of Windows to be launched late 2001. During a trip to China to discuss the planned opening of a PC manufacturing plant there, Dell Computer Chair and CEO Michael Dell speculated that demand for system upgrades could lead to a buying spree around the first quarter of 2002. Microsoft and many other software and hardware vendors had been cautious about forecasting a recovery for the worldwide PC industry, which slowed to single-digit growth in the fourth quarter of 2000. In summer of 2001, Microsoft lowered its expectation for year's PC sales growth from 10% to about 7%. "There were some indications that the PC market could be stabilizing ... but we were very mindful of the effect a further

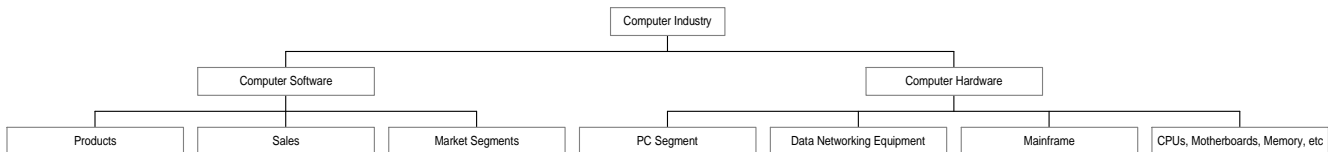
slowing economy could have on the industry and Microsoft," John Connors, Microsoft's CFO, said during an April, 2001 conference call to discuss the company's third-quarter earnings [Brewin, 2001].

At a time when the computer market was showing signs of maturity, Dell was looking to make deeper investments into the higher-margin and faster-growing server and storage segments. With \$5.4 bln in the bank, Dell was still in great financial shape. However, this was not enough. New ways to expand and increase profits had to be found. The main question to be resolved was how to differentiate Dell Computer Corporation from its competition and so achieve a winning edge over competitors within intensely competitive, rapidly changing immediate, intermediate, and long-term time frames.

### OVERVIEW: INDUSTRY ANALYSIS

The computer industry, with its two major segments computer software and hardware, as shown in Figure 1.

**Figure 1  
COMPUTER INDUSTRY**



The industry under study is computer hardware PC industry, a segment of the overall computer industry. It involves manufacturing PCs (desktops, notebooks, servers, workstations and other) and providing services ranging from maintenance and support to consulting and training to system integration. PC segment is the largest and fastest growing segment of the computer hardware industry. The declining price of hardware allowed increased market expansion and penetration. Overall PC's but also with services creating an affordable package. Competition is very intense and volatile, with all of the players offering pretty much the same product and services.

Computer hardware industry included PC vendors, mainframe vendors and makers of CPUs, memory, chips and others. The design, manufacturing and sales of PCs were the primary business of

PC hardware businesses. Computer software industry primarily design, produce and sell software, which consists of computer programs that direct the operations of the computer or carry out user tasks [Graham-Hacket, 2001].

### **Participants**

The participants in the computer hardware industry were PC makers, mainframe and various other hardware makers. Hardware equipment providers in PC segment were companies that researched, developed and manufactured various systems. Corporations in this segment also used their infrastructure to provide services to customers. Participants focused on gaining market share. It is usually done through aggressive pricing strategy, introduction of new products and services or manufacturing high quality product. The last one is strongly dependent on the brand name.

### **Products**

The computer hardware industry product line consists of PCs, data networking equipment, mainframes and other hardware. PCs furthermore could be separated in desktops, notebooks, servers, workstations and storage equipment. PC segment is the largest and fastest growing segment of the computer hardware industry. The declining price of hardware allowed increased market expansion and penetration.

### **Services**

There are two categories of services that computer hardware industry can provide. The services that usually come with the purchase of the system such as installation, customer support and maintains, and additional services such as consulting, optimization, network architecture, bandwidth capabilities, security and disaster recovery.

### **Research and Development**

One of the most important sectors that eats away billions of dollars every year. Manufactures must stay on the edge of the technological progress, in order be able recognize new markets and



opportunities. New hardware shows up on the market every six months or so. Companies have to be able to provide it with compatible support hardware. Due to such short product cycle, companies forced to change their equipment every two to four years.

### **Production**

Production in the industry could be performed either in-house or outsourced. Many companies have chosen to use a combination of these two methods or outsource everything basically becoming just a place, where all that hardware simply put together with well-known brand name stick to it. Furious competition forced companies to outsource more and more in order to stay competitive.

### **Opportunities**

There are many industry opportunities that are noteworthy. PCs purchased as replacements ahead of the Y2K problem are now coming up on year three of their lives, and many users are ready for an upgrade. Microsoft's October 2001 launch of Windows XP, given the system requirements for Windows XP (that is, additional memory and a faster microprocessor), coupled with the attractive price points of PCs in this intensely competitive environment, consumers will likely buy a new computer instead of buying just the new operating system. As well, there are growth prospects in server and storage markets. Technology, networking, customer service and support, and cost are primary determinants of system purchases. The stream of software and hardware innovation within the information technology industry is rapid and robust, and continues to sharply increase system performance and reduce the relative cost of computing, encouraging new computer users and more rapid PC replacement.

Moreover, the Internet is a part of modern daily life. Use of the Internet is improving the efficiency of Dell's procurement, manufacturing and distribution process and further expanding an already broad range of value-added services. From servers that power the Internet connection, to

desktops and notebooks that efficiently and effectively provide the interface, to workstations used to develop digital content, the ability to provide products and services that enable Internet access and enhance the online experience will be vital for companies in the computer systems industry.

Additionally, there is a rapid expansion of international markets, creating strategic alliances to develop future technology and stay on the edge in potentially high growth market. Also, the creation of strategic alliances would also help companies better serve their customers through offering a better mix of products and services. The use of cost cutting and outsourcing strategies would also lower prices for customers and increase sales even more. Therefore, understanding the large-scale and specific needs of users and supporting services will help satisfy the specific customer group.

### **Threats**

In contrast, there are also a multitude of threats. The competition in PC industry is more intense than ever. Prices continue to drop, especially since new hardware hit the market every five to six months. Profit margin drops. As well, many companies had cut down their IT budgets after buying new gear before the Y2K crunch and influenced by slowdown in the economy. Home market growth is leveling out. And, there is over saturation of the market due to high competition and product mix. Focusing too much on one segment and neglecting the others is problematic, resulting in entering secondary segments and neglecting primary segments. The high costs required to maintain technological advantage over the competition is mounting. Last, the inability of companies to meet customer demands with existing customer service and support is omnipresent.

### **Key to Success**

Keys to success here were to anticipate resumption of growth in the PC segment and to develop high quality systems with innovative features, considering customer needs and preferences, offering competitive/low pricing and ensuring technological sophistication through constant product innovation, developing effective marketing plans to establish product differentiation and a loyal

customer base.

Secondly, keys to success here were to increase market penetration and market share in the server segment, the entry level server market offered innovative features considering customer needs and preferences, offering competitive/low pricing and technological sophistication through constant product innovation. In the mid-range server market, worldwide revenues rose, developing high quality systems with innovative features considering customer needs and preferences, offering competitive/low pricing ensuring technological sophistication through constant product innovation, and open system architecture and interoperability. High end servers accounted for about 19% of annual server revenues. These platforms were in varying stages of maturity. Spending on servers had grown sharply, as customers were increasingly off-loading applications traditionally found on mainframes and minicomputers to mid-range and even high powered PC servers.

Third, workstations, developed high quality systems with innovative features considering customer needs, preferences, pricing, sophistication through constant product innovation, switching to Microsoft Windows NT/2000, switching to UNIX workstations and open system architecture and Interoperability.

Forth, suppliers were important. Manufacturing a PC required a large volume of components, all of which had to be of high quality and compatible with one another. Some computer system vendors offered their customers up to 100 different products, all of which demanded different amounts of specialized parts and raw materials.

Fifth, in recent years the main challenge for computer hardware firms had been to satisfy the marketplace's insatiable demand for their products. However, a company rushing to fill market demand may, after a sudden shift in technology or market sentiment, could find itself saddled with devalued or even obsolete stock. Matching inventory levels with demand, understanding of current

demand trends, keeping spare inventory back, having an inventory system in place to meet a sudden rise in demand afforded successful inventory management.

Sixth, keys to success here were to employ both direct and indirect selling models to compete with logistical efficiency of direct selling, while still offering the customization and service capabilities of the retail channel. Outsourcing distribution of non-core business segments can be done more efficiently elsewhere through alliances while setting up distribution centers in key market areas, to ensure customer satisfaction should problem with distribution arise.

Seventh, the keys to success therefore, were to capitalize on combining sales of services and support with products to create affordable value package. Other keys to success were in maintaining exceptional service and support to meet all the needs of a company, with automated on-line centers, consumer on-site support, consumer over-the phone support, and consumer education about the system and options available with it.

Eight, the industry provided systems and services to public institutions such as State, Local, and Federal Governments, as well as education and healthcare organizations. It provided strong support package with staff available 24/7, customized web sites created for a specific agency/department, long-term lease options for installed systems and correct step-by-step installation and delivery.

Ninth, small, medium and large businesses were of course the main profit generator of the industry. With the importance of networking, Intranet, Internet and e-commerce skyrocketing since the early 90's just fast and easy solutions were needed for the survival of companies. The keys to success therefore were to maintain exceptional service and support to meet all the needs of the company. Customized web sites to promote the on-line support were a must. As well as, keys to success were in understanding the large-scale needs of corporations, offering lease options, on-time fast installation

and delivery and corporate pricing discounts.

Tenth, keys to success in PC pricing were to introduce competitive/low pricing, aggressive pricing to maintain or increase market share. Sub-\$1,000 systems were successful in raising the penetration of PCs in the home market. Increased use of direct sellers methods should help companies to gain efficiencies and narrow the price gap between direct and indirect sellers.

Eleventh, the Internet had injected a tremendous growth opportunity into the computer hardware industry. The keys to success were the ability to adapt to market changes. The evolving e-commerce market penetration, adapting product mix to on-line sale and internal practices and business models to on-line sale. Customized user “friendly” web sites for each corporate customer. And, successful on-line automated technical support for individual consumers, targeting specific customer groups.

Twelfth, the keys to success in Research and Development were allocating sufficient resources for effective research, creating technology that meets customers needs and preferences, to be able to bring new technology to the market before competitors did and to upgrade existing technology in order to diversify away risk of the uncertainty of new technology. Additional keys to success were the ability to invest large amounts of money into risky new technology and create strategic partnerships and acquisitions.

Last, promotion and advertising were important keys to success enabling the creation of brand recognition and brand loyalty through distinction by creative TV ads, and creating brand recognition and brand loyalty through distinction by using magazine ads and web advertising.

### **THE COMPANY**

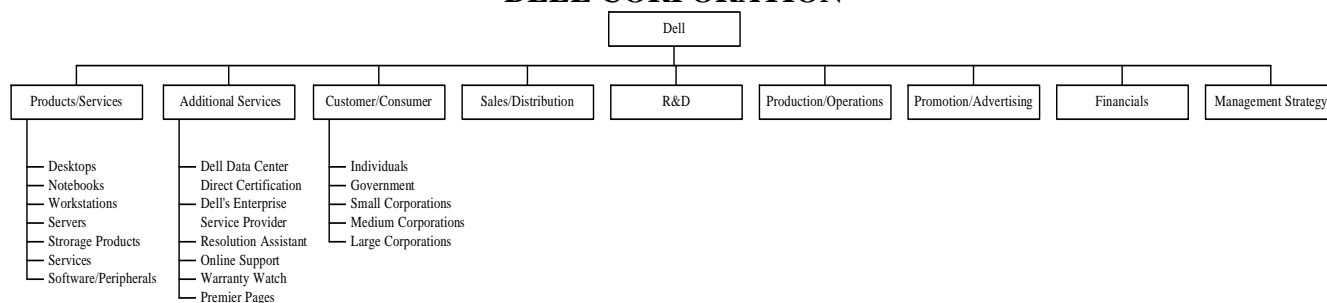
"We don't have to turn around and evacuate the client side – the desktops and the notebooks – because they were very healthy businesses for us. They're in the past for the competition because they

haven't figured out a business model that works. The PC was a very solid business; there was strong demand for desktops," said Bell (president of Dell Computer in Europe, the Middle East, and Africa). He added: "It was important for our customers that we're not badmouthing PCs. Our customers want to use them and want to buy them. We're investing in that area. With other people cutting investment, customers were going to see where they would get a better experience." Carly Fiorina, HP chair and CEO, took her own swipe at Dell in a presentation defending her company's proposed takeover of Compaq. She claimed that Dell, with its focus on volume and velocity, wouldn't survive in the long term as it lacked resources for research and development, sales, and marketing [Evers, 2001].

## Products

As shown in Figure 2, the company designed, developed, manufactured, marketed, serviced, and supported a wide range of computer systems, including desktops. Notebooks, workstations, servers, storage products, services, and software/peripheral products.

**Figure 2**  
**DELL CORPORATION**



Desktops. There were two models: (1) *OptiPlex*, a desktop computer that was developed for corporate and institutional customers who needed highly reliable systems within networked environments. Industry-wide compatibility contributed to the high dependability of OptiPlex systems, which had the lowest downtime rates among those from all major manufacturers, according to a leading PC publication. (2) *Dimension*, a desktop PC that was designed for small-business and home users requiring fast technology turns and high-performance computing. The product line commonly

featured the latest relevant PC technology on an award-winning platform.

Notebooks. *Latitude* - notebook PCs provide large corporate, government and education customers with reliability, stability and superior battery performance for complex networked environments. Important Latitude features included lower total cost of ownership, outstanding network connectivity and broad operating-system support. *Inspiron* - notebook computers were targeted at customers who require high-performing computer systems at aggressive prices, along with industry-leading service and support. Such customers were typically individuals or small to medium-sized businesses that were looking for optimum performance for their system investment.

Workstation. The Dell *Precision* workstations were ideally suited to run complex applications, such as three-dimensional computer-aided design, digital content creation, software development, and financial/economic modeling. Customized to users' needs, they offered high-performance technology in an affordable, state-of-the-art solution.

Servers. The *PowerEdge* network servers had made Dell the fastest-growing company in the category since their introduction in September 1996. All *PowerEdge* products offered users performance, reliability, availability, and scalability comparable to proprietary high-end systems, but were based on compatible, open standards and were more affordable.

Storage. The *PowerVault* storage products were designed to drive high-end storage features into standard computing environments, meeting a wide range of customer storage needs.

Services. Dell offered a variety of award-winning services, such as factory installation of proprietary hardware and software, leasing and system installation, warranty coverage, and user support. The company was further developing its service capabilities with Internet-based services that enhanced customer experience. Examples included "E-Support - Direct From Dell," which provided advanced online customer support capabilities; Dell Talk, an online discussion forum; Ask Dudley, a

natural language search engine; Dellnet Internet access; and the Dellnet.com portal site.

Software and Peripherals. Dell provided more than 30,000 competitively priced software and peripheral products from industry-leading manufacturers which complemented the company's systems offerings. Dellware products, including memory upgrades, printers, monitors, and software packages, were available through Dell's online superstore, [www.gigabuys.com](http://www.gigabuys.com) [Dell, 2001A].

Some 80% of Dell's sales came from PCs and notebooks. Dell could not allow its profit margins on PCs to fall any lower than 3%, and it would need to boost its worldwide market share from 13% to 23% by 2003 just to keep earnings flat, said IDC analysts. Dell had launched a price war in the low end of the PC market, dropping its server margins from roughly 27% to 20% in 2000 and 2001. To get better profits, Dell had to beat the likes of Sun and IBM, who made high-end servers with 40% plus margins. Dell had only a 4.5% share in the storage segment, since it required large R&D efforts -- not one of Dell's strong point. Still, Dell was targeting the storage segment since it was a \$29 bln market, with 25% gross margins. As of late 2000, buyers preferred IBM, EMC, and others. Services were a \$395 bln market that carried 20% plus operating margins. It contributed just 10% of Dell's revenues. Senior management hoped they could boost the business by 30% a year. Dell's aim was to solve customer problems with simple and easy to use software solutions instead of armies of consultants. Dell wanted a share of the \$5 bln market for low-end networking gear used by small businesses. Dell's plan was to under-price rivals by some 50%, gaining the share quickly. But given the small market size, this did not work well for Dell [Business Week, 2001B].

Dell's product line could be separated into three major parts: personal computers, servers and workstations. The company was very strong in that area. The company was able to provide everything that customer/consumer and market wanted, from technological stands to service/ support capabilities. PCs were "bread and butter" of Dell, the company got more than 40% of their total sales from that



segment. That's why the company had to and did pay special attention to that segment, making sure that everything from systems themselves to pricing to after sale service were no less than excellent. Although Dell got into server segment relatively recently it had proven to be a worthy opponent to such well established companies as IBM, Compaq and others. It performed exceptionally, especially in entry-level and high-end servers. Dell had an issue with ability to provide technological sophistication through constant product innovation in mid-range server segment, but it was only because the company was still trying to establish where mid-range servers should be in the market. Another big winner for Dell was its workstation segment. The only issue that Dell really had was with UNIX workstations, since company completely abandon that OS for MS Windows NT/2000 one.

### **Additional Services**

Additional services included: Dell Data Center Direct Certification, Dell's Enterprise Service Provider Center, Dell's Enterprise Service Provider Center, Online support, Warranty Watch, and Premier Pages.

Dell Data Center Direct Certification. This program was a referral list of consultants and ASPs (application service providers) for Dell customers that needed to outsource back-end computing functions, such as managing e-commerce sites. Dell had increased its focus on selling services in 2000 and 2001. Part of the shift came as a result of the company's changing product mix. It sold more servers and storage systems in late 2001 than in the past, and many businesses were choosing to turn over the management of this sort of back-end hardware to third parties. While competitors, such as IBM and HP, had often relied on internal service organizations to provide many of these functions, Dell had historically teamed with third parties such as Unisys. Recently, however, Dell had expanded its internal service organizations. It began with Internet service provider certification programs, later expanding to ASPs. In 2001 it was going to bat for large corporate customers in the hunt for service

providers who offered data center-based outsourcing services. Dell officially inked a new billion-dollar agreement with Unisys.

Dell's Enterprise Service Provider Center. Dell, as part of the new program, would partner with 4 or 5 large service providers, qualifying them on the technological nuances of using Dell hardware in various computing environments. "We're going in there and we're helping them build reliable e-infrastructure," said Mike Nabhan, a brand manager in Program. The company planned to limit the program, however, to deliver better services to its larger IT customers. "We're going to recognize and promote these partners," Nabhan said. But, he added, "We're going to pick and choose just a few. Probably just a handful" [Dell, 2001B]. Dell would test network architecture, bandwidth capabilities, security and disaster recovery, among other aspects of a data center. The evaluation program also included training and validation, in which simulated failures would be used as a test of the data center. Those service providers that partnered with Dell would also be able to market their status under a Dell Data Certified logo. Dell was following in the footsteps of some other hardware sellers, such as Sun Microsystems, which touted its SunTone program as the Good Housekeeping seal for the Net, said John Madden, analyst with Summit Strategies in Boston. Under the program, Dell would also put a new support team into service. The team would include systems consultants with expertise in data centers. As part of a new Enterprise Expertise Center, the team offered a single point of contact and customer system availability guaranties, the company said. Dell said it would offer consulting services for businesses setting up Internet sites, teaming with Arthur Andersen and Gen 3 Partners. Dell offered direct services for Internet service providers and had set up an initiative for Internet access services and products, including wireless and high-speed Internet access [Dell, 2001B].

Dell's Enterprise Service Provider Center. Dell discontinued its online support tool, at the end of July 2001. Resolution Assistant let customers engage in live chats with technicians and allowed the

techs to carry out diagnostic tests remotely. "It wasn't giving customers the satisfaction we needed it to," reported Dell spokesperson Bryant Hilton. Dell ended up receiving many phone calls following online sessions, Hilton adds. And that's not the way online help was supposed to operate. For now, Dell would offer e-mail support but not online chat. The company said it was continuing to evaluate future online tools [McLaughlin, 2001]. Eager to maintain its leadership in direct PC sales, Dell redesigned its massive Web site again, sporting a less chaotic interface and easier access to sales and support. Advanced computer users had always liked Dell's Web-based technical support services. Depending on the user's level of knowledge, the site presented one of two layouts. One, for the type of visitor Dell called a "browser," offered many possible solutions and let users you scroll through it to find the answer. The second layout was for a "solver" who wanted a more direct answer. Through that template, the site continued to ask specific questions until it found a solution.

Online support. About 19 million visitors went to Dell.com's support site each year, according to Dell's metrics. About 40% of Dell customers used it; Dell improved that to 50% in 2001. The website generated \$35 million in sales daily.

Warranty Watch. In addition to making support easier to access, the redesign added some extra features such as the program, which notified customers when the warranty on their Dell product began to run out, and offered to extend it. Warnings appeared 180, 90, and 30 days before the warranty expired. Even if the redesigned site drew more visitors, Dell probably would have never done all its sales and support online. "The fact is, some small group of people would always use the phone," Lueckenhoff (VP for Home and Small Business Group customer service and support) said [Mainelli, 2000].

Premier Pages. Dell also developed custom Internet sites, called for by various corporate and

institutional customers, allowing these customers to simplify and accelerate procurement and support processes. Through these custom sites, Dell offered paperless purchase orders, approved product configurations, global pricing, real-time order tracking, and purchasing history and account team information. The company provided more than 40,000 Premier Pages worldwide. Dell also provided an online virtual account executive for its small business customers. And, for all domestic customers, the company provided a spare-parts ordering system, and a virtual help desk featuring natural-language search capabilities and direct access to technical support data [Standard & Poor's, 2001].

### **Customers/Consumers**

Not all Dell customers were created equal, nor were they treated equally. Dell's data enabled it to know the ultimate fact about its largest customers, exactly how profitable they were. The more money a customer brought in, the better treatment s/he received; for instance, someone who bought servers and storage from Dell was more likely to also purchase a special package that included PCs and portables. Dell's satisfaction ratings were perhaps the best in the industry. Dell's customers included individuals, government, and corporations.

Individuals. The direct sales model was best used by the individuals since it could satisfy every consumer on an individual basis. Every individual customer could go to Dell's web site to select and customize any system desired. And on top of that they could get a good price on it. Overall the issues that Dell was facing providing on-site support for individual customers and with the over-the-phone order, was that there were some complains that customers had to stay on-hold for the long time before they got to speak with somebody. It was decided that it was not cost effective to invest a lot of money into this function. Dell decided to replace army of consultants with automated on-line support centers. Otherwise, Dell was well known for good customer relationship with strong points on education of the consumers on the latest system features and options available and for providing excellent delivery

service.

Government. Dell provided systems and services to public institutions such as State, Local, and Federal Government, as well as education and healthcare institutions. All found easy and fast solutions to the challenges they were facing. Overall there were no issues that Dell had to deal with. The company came out to be strong in the whole segment. Dell realized the importance of providing support for government agencies all year around, 24 hours a day. The company praised itself for creating sophisticated online support database with customized web sites for each function. And since it was presumed that government was here to stay, there were no problems with providing it with long-term leasing option. Dell was always strong with delivery and installation functions, and was well known for good customer relationship.

Corporations. Small, Medium, and Large businesses were, of course, the main generators of the Dell. The company could provide everything from beginning to the end, including products and services. Overall the only issue that Dell had was with its ability to maintain exceptional service and support to meet all the needs of customer/consumer. Due to the lay-offs, the company's human resources were stretched pretty thin and sometimes unavailable. Otherwise, Dell was well known for good customer relationships. The company was able to capitalize on combining sales of services and support with products to create affordable value package and furthermore combining with the ability to maintain exceptional service and support to meet all the needs of a company. Whenever Dell was involved in a project it demonstrated understanding of the large-scale needs of a corporation and always provided the right solution and was able to back it up with services in a wise, affordable, and timely fashion.

### **Sales/Distribution**

Since 1996, there was only one company – Dell – that kept making record-setting revenue and

profit growth. It designed, manufactured, and customized products and services to customer requirements, and offered an extensive selection of software and peripherals. Customers could configure computers in many different ways, buy 40,000 different types of peripherals and software, access a massive knowledge-base of customer support information, and track their orders from manufacturing to delivery. This relatively young firm (created by M. Dell in 1984) was rocketing past rivals in all the hottest market segments. The Internet had provided a great opportunity for Dell's direct-selling model, allowing the company to move more than \$35-40 million worth of computers a day via the Internet. Starting from scratch allowed Dell to create a state-of-the-art, direct-sales model. Over a 17-year period it had been able to tune its ordering and manufacturing processes – and update them for the Web. That's how it was able to customize and assemble more than 25,000 different computer configurations for buyers in 2000 alone. Dell dealt with hundreds of suppliers, but about 90% of its parts and components came from two dozen companies. It also worked closely with them to make sure the parts were designed for snap-in assembly and just-in-time delivery to its factories. It had provided the lowest overall cost to the customers, and since the cost structure was less than half of competitor. As a result, Dell had one integrated process for managing the entire value chain, from component supplier to end customer – and it controlled all the aspects in-between.

At the heart of those characteristics was Dell's unique direct-to-customer business model. "Direct" referred to the company's relationships with its customers, from individual consumers to the world's largest corporations [Park, 2001]. There were no retailers or other resellers adding unnecessary time and cost or diminishing Dell's understanding of customer expectations. In late 2001, a custom order placed at 9 a.m. on a Monday could be on a delivery truck by 9 p.m. Tuesday. What's more, this speed had allowed Dell to slash inventory and keep parts costs down so low it could under-price its rivals by 10-15%. Dell had long been a model of just-in-time manufacturing, but it had raised the stake

by applying the same brutal time standard to its supply chain, insisting, for example, that the bulk of its components be warehoused within 15 minutes of a Dell factory. Dell also had seized on the ultimate in low-cost, fast-paced business – e-commerce. The combination puts Dell in the front line of manufacturers in any industry. Affected by slowdown in the economy the business of selling desktop computers to corporations and institutions was sagging. Prices were going downward and demand was soft. Analysts believed that this was just a short-term problem. After increasing budgets to buy new gear before the Y2K crunch and affected by economic slow down, many companies were now cutting IT budgets. There was the long-term trend toward putting IT money into back-office gear to run e-commerce, rather than upgrading desktop systems. The share of corporate IT budgets allocated to PCs fell from 23% in 1999, to 18% in 2000, to even lower in 2001. Any slowdown in corporate PCs was bound (and did) to hit Dell hard. The company received 40% of revenues from corporate desktops – compared with 21% for Compaq. Given the soft market, Dell would have to work harder to keep its corporate desktop line growing. In 2001, the unit growth was just 18%, and revenue growth was about 8% with average price for unit desktop to fall by almost 10%.

According to the company, total product shipments were up 36% in the fourth quarter and 50% for 2001, as industry analysts ranked the company No.2 worldwide for both the three- and 12-month periods. Dell continued its rapid, profitable growth in global sales to small businesses and home-PC customers, which rose 57% from the year-ago quarter. Overall, Dell's fourth-quarter revenue increased 39%, and shipment growth was nearly triple the industry rate in 2001. The company was No.1 in the overall US PC market for the third straight quarter, and earned the top full-year share for the first time. Sales to Americas home and small-business customers were up 64%. Combined regional sales to small and medium-sized companies, where Dell was the market leader, jumped 65% in the quarter. Like larger corporations, those companies were choosing Dell for servers and storage products

as they built what Mr. Dell called "the backbones" of their online businesses. European revenue rose 8%, as the company's product-shipment growth exceeded the industry average. Company revenue from Asia-Pacific and Japan was up 56% during the fourth quarter-sales in China, now Dell's eighth-largest market, more than doubled as regional unit volume grew nearly one and one-half times faster than the total industry.

Dell's direct sales model and tight cost controls left it in the good position to survive the industry slowdown. The strategy not only allowed the company to take prices to low-end extremes, but also gave it tremendous flexibility. The direct model allowed it to quickly adjust its offerings in accordance with demand through rapid product change. More importantly, product transitions did not leave it stuck with useless inventory. While price cuts were helping Dell gain market share, they were not the ones that drove PC demand: the market share gains were coming at the expense of the competition, not industry growth. As such, Dell's reduced cost structure also reflected slowing industry growth prospects. 2001 proved to be challenging, but Dell was able to increase sales and gain market share, company's distribution channels demonstrated themselves to their best ability. Everywhere from the ability to employ direct selling channels to the ability to provide good customer service to ensure customer satisfaction Dell came out strong. The only issue the company had in this area was its ability to set up distribution centers in international markets. Although the company was doing very good in global markets, it was still not as strong as IBM. Dell had no retail sales, yet had no problem with outsourcing some business functions as long as it cut cost for them.

### **Research & Development**

One of the biggest weaknesses of Dell was that it had to rely on R&D of others to manufacture their own products and services. R&D was completely absent as a part of the corporation. To start its own R&D department Dell would need to spend a lot of cash and, considering a slow economy and



falling profit margins, that was not a good idea at the moment. The best bet was to ally itself to the company with a strong R&D present or buy such a company. Dell had successfully developed cooperative and working relationships with many of the world's most advanced technology companies. Working with these companies, Dell's engineers managed quality, integrated technologies, and designed and managed system architecture. This cooperative approach made it possible to determine the best method and timing for delivering new technologies to the market. Since R&D was the weakest point in Dell's infrastructure the company's management used all of the available resources to archive strategic partnerships and acquisitions, through which the company was also able to upgrade existing technology in order to diversify away the risk of introduction of new technology.

### **Production/Operations**

While most computer components were standardized and were available from multiple sources, relying on suppliers for crucial components involved several risks: the possibility of defective parts, shortages, and cost increases. Therefore, manufacturers generally relied on one or two suppliers; more than 80% of the world's PCs included an Intel processor. The company dealt with hundreds of suppliers, but about 90% of its parts and components came from two dozen companies. It worked closely with them to make sure the parts were designed for snap-in assembly and just-in-time delivery to its factories. It had provided the lowest overall cost to the customers, and the cost structure was less than half of competitors'. As a result, Dell had one integrated process for managing the entire value chain, from component supplier to end customer – and they control all the aspects in-between [Dell, 2001C]. The company calls it "velocity," squeezing time out of every step in the process – from the moment an order was taken to collecting the cash. Dell converted the average sale to cash in less than 24 hours, by tapping credit cards and electronic payment. By contrast, one of the industry leaders – Compaq, which sold through dealers and online, took 35 days, and rival Gateway 16.4 days. Dell

didn't stop there. It had also found a way to get most suppliers to keep components warehoused just minutes from Dell's factories in Austin (Texas), Limerick (Ireland), and Penang (Malaysia). In part, Dell had done this by reducing its number of suppliers to those that would cooperate with its warehousing plan. Dell bought its components from just 47 companies, down from 204 companies in

1992. Keeping the flow of parts running smoothly required precise coordination. For this, Dell had turned to outside help. In the US, for example, Caliber Logistics Inc., a specialist in setting up efficient supply chains, managed a warehouse 15 minutes from Dell's Austin assembly plant. Suppliers restocked the warehouse and managed their own inventories, while Caliber shipped the parts to Dell as needed. Dell didn't get billed for the components until they leave the warehouse.

The system was very efficient. STB Systems Inc., a maker of video graphics cards, stocked 3 weeks worth of its products in warehouses near Dell plants. The Richardson Company also supplied PC makers such as IBM, Compaq, and Gateway, but none were as streamlined as Dell. If Compaq were to suddenly need a rush supply, it could take 12-18 hours. IBM and Gateway, he said, could take two days. "Dell was different in that their inventory was minutes away – not hours or days," said STB procurement director Rick Spencer. For high-cost items, such as the motherboard, Dell had cut more time by switching to regional suppliers. Dell used to order in bulk from one supplier as a way to get discounts – no more. Last year, it went to three regional subcontractors instead of a single manufacturer for all. What it lost in discounts, it more than made up for in time. Now, Dell's Austin plant had circuit boards trucked in from Mexico in 15 hours, instead of 22 days by boat from its previous Indian supplier. In 1999, Dell stopped accepting deliveries of video displays for its PCs. Instead, when a machine was ready to be shipped from any of its factories, Dell sent an e-mail message to a shipper, such as UPS. The shipper pulled a computer monitor from supplier stocks and scheduled it to arrive with the PC. By not shipping monitors first to Dell and then on to buyers, Dell saved some

\$30 per display in freight costs.

### **Promotion/Advertising**

As computer hardware manufacturers differentiated themselves by quality of service and product, it was important for them to promote their brand names and images among potential customers. Dell employed several strategies, such as an aggressive TV campaign directed at the teenagers and their parents. Monthly Dell magazine with latest news, offers, and savings was easy to subscribe to online or by phone. Newspaper and magazine ads were looked at as important tools to target older markets. Dell came out with a strong promotion/advertising campaign in 2001. Dell's budget allowed the company to engage several types of media with strong representation. Especially noticeable was the company's TV presence with a strong campaign directed towards younger generations and their parents.

### **LOOKING TOWARDS THE FUTURE**

The company's objective was to maximize stockholder value by executing a strategy that focused on a balance of three priorities: liquidity, profitability, and growth. Management believed that opportunity existed for continued worldwide growth by increasing the company's market presence in its existing markets, entering new markets, and pursuing additional product and service opportunities. The company continued to expand its product and services offerings to meet a variety of customer needs. Also, the company continued to enhance and improve the reputation, quality, and breadth of all of its product lines and services. The company was continuing its efforts to strengthen its position in enterprise systems by introducing advanced technologies to serve the growing needs for these products.

Michael Dell's weapon in the battle to expand its growth, spike its stock, and conquer new markets was not expected to be radical new technology. Instead the company would bring to the fight

what it always had: the managerial skills that enabled it to move quickly, and the discipline that enabled it to keep costs low, allowing it to ruthlessly undercut prices and conquer market share at increasing rates. Unlike most big companies, Dell had expanded resourcefully on its direct model to improve on everything from supply-chain management to customer relationships to marketing. Despite its growth, it had remained obsessively focused on execution [Watson, 2001].

Meeting with his executives Michael Dell expressed his satisfaction with latest sales numbers. However, they realized they couldn't squeeze profit margin forever. Two main alternatives were introduced.

One of the executive managers was pushing for expanding Dell's international market share. He argued that international markets presented a promising opportunity for PC makers in the years to come. The proposed alternative would **benefit** the company by maximizing profits and increasing global market share. As the US market matured, the company should be looking abroad for faster growth rates. Global diversity also allowed for manufacturing cost savings, while promoting increased flexibility to meet customer demand. This need to expand to international markets had crowded out many smaller players that didn't have the financial resources to compete on that scale. Such a strategy was **feasible** because of a recent example of areas such as the Asia-Pacific region and Latin America that witnessed stronger growth rates than the worldwide average in the mid-1990s. From late 1997 through 1998, however, economic difficulties dampened PC growth in those areas, while the more mature markets of the US and Europe continued at a healthy pace. In 2000, the tables have turned, with Asia-Pacific, Japan, and Latin America again leading worldwide unit growth. For example, the US grew just 8%, while the Asia-Pacific region surged 38%. This strategy would enable Dell to **win against** its main competitors, because Compaq, IBM, HP, and others were not efficient enough to match prices Dell offered. Furthermore, with the Dell's efficiency and excellent quality service it

would be relatively easy to build up the brand name and loyalty. A **drawback**, however, would be if Dell was still able to maintain the same quality level of organization and same quality of products/services. Since Dell now had to be able to compete on a worldwide basis that required substantial investment in global manufacturing and distribution infrastructure. A **way around the drawback** was outsourcing. For example, the company could have contracted much of its manufacturing needs to contract manufacturers, or electronics manufacturing services. This would let Dell quickly build up its worldwide capacity in response to strong demand, without making significant capital expenditures to do so. As the PC industry became more global, Dell could increasingly pursue outsourcing relationships when it was economically feasible and when it reduced the time needed to get a product to market.

Another alternative would be for Dell to concentrate on high-end PC market (especially high end server and storage equipment), since Michael Dell predicted resurgence in PC demand in spring of 2002. Dell hoped for the future on users who wanted more powerful computers, since they were cheaper than ever. Dell told analysts "of the 450 million machines out there, less than 10% have 1 gigahertz of processing capacity." Instead of getting a mid or low-performance system, Dell thought many companies would want top of the line systems whether they needed them or not. The **benefit** was that high-end PCs were the most profitable product that the company had, so selling more expensive systems would bring more cash. This strategy was **feasible** because the company could offer those systems at lower prices than the competitors. It also would enable Dell to win against other players in the market because even at the lower price the company would have a higher profit margin. A major **drawback** was most PCs already had more power than most software needs today. A powerful computer was largely irrelevant to users who mainly surfed the Internet, sent e-mail, and prepared personal documents. "The applications used by the average corporate user were Word, Excel, e-mail,

and an Internet browser," pointed AG Edwards' Miller out. "It doesn't make a rat's rear-end's worth of difference whether you run those on a machine with a 500 megahertz or a gigahertz" A **way around the drawback** was to offer affordable combination of products and services with value saving leasing options. It was important to educate the customers about the necessity of purchasing powerful systems as a preemptive move to secure their position in ever-changing Internet and business environment. Open system architecture and interoperability were requirements for competing in today's multi-vendor user environment [Popper, 2001].

These strategic alternatives suggested were just two of the ways executives felt Dell should consider to further maximize company's profits in the short-term and to stimulate growth in the long-term. The proof would come in the second or third quarter of 2002, when all the PCs companies bought in the first half of 1999 were due for replacement, according to the typical corporate upgrade cycle. "People could push out replacements six to nine months," Dell told analysts. "But unless there was a protracted economic problem, we don't see [corporate managers] going to a four- or five-year replacement cycle." If IT budgets haven't loosened by the middle of next year, the corporate chief information officers might take advantage of low-priced machines to replace immediate weak spots in their systems. For longer-term planning, IT managers would be focusing less on the sticker price of a machine than on the overall cost of ownership, which included whether the maintenance costs were reasonable. That's not necessarily a positive for Dell. "Dell's not as strong in services and support as Compaq, IBM, or even Hewlett-Packard" Miller says [Popper, 2001].

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**DELL COMPUTER CORPORATION: COMPUTER HARDWARE INDUSTRY**  
**Instructor's Guide**  
**Teaching Note**

**ABSTRACT**

Speaking at International Data Corporation's (IDC), European Information Technology (IT) Forum, Paul Bell, president of Dell Computer Europe, the Middle East, and Africa, said consumers should keep buying. "We expect great bargains for a while. It was a great time to buy. Pricing feels less brutal to us because it still was a profitable business. You would continue to see massive amounts of innovation – if nothing else, in size: smaller and more portable. The personal computer (PC) was changing more rapidly now than in the previous ten years," Bell said [Evers, 2001]. Bell responded to Michael Capellas, Chair and CEO of Compaq Computer, who said in a crucial address that "brutal pricing" would last and "PC innovation would stagnate" [Evers, 2001]. Despite the slowdown in the economy Dell was able to reassure its investors (backing it up with the profits), that its stock price trading range was between \$15-\$31 throughout the year. At a time when the computer market was showing signs of maturity, Dell was looking to make deeper investments into the higher-margin and faster-growing server and storage segments. With \$5.4 bln in the bank, Dell was still in great financial shape. However, this was not enough. New ways to expand and increase profits had to be found. The main question to be resolved was how to differentiate Dell Computer Corporation from its competition and so achieve a winning edge over competitors within intensely competitive, rapidly changing immediate, intermediate, and long-term time frames.



**DELL COMPUTER CORPORATION**  
**COMPUTER HARDWARE INDUSTRY**

**Instructor's Guide**

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**1. OVERVIEW AND INSTRUCTIONAL PURPOSE OF THE CASE**

The industry under study is computer hardware PC industry, a segment of the overall computer industry. It involves manufacturing PCs (desktops, notebooks, servers, workstations and other) and providing services ranging from maintenance and support to consulting and training to system integration. Providing right hardware for a low price and ability to meet customer demands are main factor determine customers' choice of where to buy a system.

Information technology was rapidly advancing creating new functionality and capabilities to improve business process. To support new advances computer industry had to provide sufficient hardware and software. PC segment is the largest hardware segment. Biggest problems were slowdown in the economy and decline of PC sales after companies bought new gear in preparation for Y2K. Companies had to come with the ways to provide high quality systems for a low price.

In light of the changing computer environment and overall industry slowdown, management was faced with strategic decisions.

The overall objective of the case is to enable students to practice their managerial skills by putting them against real-life scenario, so they could differentiate chosen company from the competition. Doing that would enable management to win against competitors in short and long-term.

- To evaluate a company's competitive market position within a given industry
- To evaluate how a company reacts to opportunities and threats within the industry
- To evaluate how a company identifies keys to success within an industry and uses them to gain a competitive advantage over competitors
- To evaluate company's ability to react to a changing market place and develop alternative strategies to deal with this change
- To increase a student's ability to analyze and conceptualize a given situation in order to develop future planning skills
- To increase a student's ability to evaluate a situation and effectively communicate both written and verbally, remedies for the situation
- To increase student's ability to understand a situation or problem by identifying patterns and addressing key underlying issues in order to develop strategic future thinking that is needed for effective leadership and management in the marketplace

## **2. THE CASE AS IT RELATES TO THE STRATEGIC MANAGEMENT THEORY**

First, the case is a good illustration the issues that PC makers have to deal with in the today computer industry environment. This report uses the applications of strategic management theory in the today's marketplace. The strategic thinking required to meet these challenges. The use of qualitative methods to identify a company's resources are increasingly important as each firm is considered to have a distinctive bundle of recourses in a challenging ever-changing environment. This focuses on Michael Porter's studies [1995] showing what the companies need to do to effectively compete in the ever changing market place.

Second, as Henry Mintzberg [1989] has pointed put in situations like this, skill in the crafting of details of the strategic plan, a step required of students working on this case study, can be more important to success than the overall strategic pattern formulation. The crafting success is aided considerably by the use of the comparative and competitive matrix, a variation of the traditional and general SWOT analysis.

Third, Peter Senge [1995], has focused on treating corporations as units. The case study enhances the individual's perception of treating each unit as a relationship with other units, which is an approach to organizational design.

Fourth, it focuses students' attention on two aspects of strategic planning today: winning against the competition by differentiation [Mockler, 2001] and doing that over three time frames which consist of the immediate, intermediate, and long-term future [Baghi, et al. 1999].

## **2. SUGGESTED DISCUSSION QUESTIONS AND ANSWERS**

### **A. Overview of the Industry and its Structure**

The industry under study is computer hardware PC industry, a segment of the overall computer industry. It involves manufacturing PCs (desktops, notebooks, servers, workstations and other) and providing services ranging from maintenance and support to consulting and training to system integration. PC segment is the largest and fastest growing segment of the computer hardware industry. The declining price of hardware allowed increased market expansion and penetration. Overall PC's price drop opened up new opportunities for PC makers to provide customers not only with a product, but also with services creating an affordable package. Competition is very intense and volatile, with all of the players offering pretty much the same product and services.

Computer hardware industry included PC vendors, mainframe vendors and makers of CPUs, memory, chips and others. The design, manufacturing and sales of PCs were the primary business of PC hardware businesses. Computer software industry primarily design, produce and sell software, which consists of computer programs that direct the operations of the computer or carry out user tasks [Graham-Hacket, 2001].

### **Participants**

The participants in the computer hardware industry were PC makers, mainframe and various other hardware makers.

Hardware equipment providers in PC segment were companies that researched, developed and manufactured various systems. Corporations in this segment also used their infrastructure to provide services to customers. Participants focused on gaining market share. It is usually done through aggressive pricing strategy, introduction of new products and services or manufacturing high quality product. The last one is strongly dependent on the brand name.

## **Products**

The computer hardware industry product line consists of PCs, data networking equipment, mainframes and other hardware. PCs furthermore could be separated in desktops, notebooks, servers, workstations and storage equipment. PC segment is the largest and fastest growing segment of the computer hardware industry. The declining price of hardware allowed increased market expansion and penetration.

## **Services**

There are two categories of services that computer hardware industry can provide. The services that usually come with the purchase of the system such as installation, customer support and maintains, and additional services such as consulting, optimization, network architecture, bandwidth capabilities, security and disaster recovery.

## **R&D**

One of the most important sectors that eats away billions of dollars every year. Manufactures must stay on the edge of the technological progress, in order be able recognize new markets and opportunities. New hardware shows up on the market every six months or so. Companies have to be able to provide it with compatible support hardware. Due to such short product cycle, companies forced to change their equipment every two to four years.

## **Production**

Production in the industry could be performed either in-house or outsourced. Many companies have chosen to use a combination of these two methods or outsource everything basically becoming just a place, where all that hardware simply put together with well-known brand name stick to it. Furious competition forced companies to outsource more and more in order to stay competitive.

## **B. Opportunities**

- PCs purchased as replacements ahead of the Y2K problem are now coming up on year three of their lives, and many users are ready for an upgrade
- Microsoft's October 2001 launch of Windows XP, given the system requirements for Windows XP (that is, additional memory and a faster microprocessor), coupled with the attractive price points of

PCs in this intensely competitive environment, consumers will likely buy a new computer instead of buying just the new operating system.

- Growth prospects in server and storage markets.
- Technology, networking, customer service and support, and cost are primary determinants of system purchases.
- The stream of software and hardware innovation within the information technology industry is rapid and robust, and continues to sharply increase system performance and reduce the relative cost of computing, encouraging new computer users and more rapid PC replacement.
- The Internet is a part of modern daily life. Use of the Internet is improving the efficiency of Dell's procurement, manufacturing and distribution process and further expanding an already broad range of value-added services.
- From servers that power the Internet connection, to desktops and notebooks that efficiently and effectively provide the interface, to workstations used to develop digital content, the ability to provide products and services that enable Internet access and enhance the online experience will be vital for companies in the computer systems industry.
- Rapid expansion of international markets.
- Creating strategic alliances to develop future technology and stay on the edge in potentially high growth market.
- Creating strategic alliances would also help companies better serve their customers through offering a better mix of products and services.
- Use of cost cutting and outsourcing strategies would lower prices for customers and increase sales even more.
- Understanding the large-scale and specific needs of users and supporting services to satisfy the specific customer group.

### **C. Threats**

- Competition in PC industry is more intense than ever.
- Prices continue to drop. Especially since new hardware hit the market every five to six months. Profit margin drops.
- Many companies had cut down their IT budgets after buying new gear before the Y2K crunch and influenced by slowdown in the economy.
- Home market growth is leveling out. Over saturation of the market due to high competition and product mix.
- Focusing too much on one segment and neglecting the others.
- Entering secondary segments and neglecting primary segments.
- The high cost required to maintain a technological advantage over the competition.
- The inability of companies to meet customer demands with existing customer service and support.

### **D. Key to Success**

#### **Product Line**

##### **Personal Computers**

- developing high quality systems with innovative features considering customer needs and preferences

- offering competitive/low pricing
- ensuring technological sophistication through constant product innovation

### ***Server Segment***

#### **Entry-level Servers**

- developing high quality systems with innovative features considering customer needs and preferences
- offering competitive/low pricing
- ensuring technological sophistication through constant product innovation

#### **Mid-range Servers**

- developing high quality systems with innovative features considering customer needs and preferences
- offering competitive/low pricing
- ensuring technological sophistication through constant product innovation
- open system architecture and interoperability

#### **High-end Servers**

- developing high quality systems with innovative features considering customer needs and preferences
- offering competitive/low pricing
- ensuring technological sophistication through constant product innovation
- open system architecture and interoperability

#### **Workstations**

- developing high quality systems with innovative features considering customer needs and preferences
- offering competitive/low pricing
- ensuring technological sophistication through constant product innovation
- switching to Microsoft Windows NT/2000
- switching to UNIX workstations
- open system architecture and interoperability

#### **Suppliers**

- limiting the number of outside suppliers to as few as possible,
- forming partnership with suppliers
- guarantying suppliers a purchase of a certain amount of components
- support, delivery and capacity are on the level where supplier can meet a sudden rise in PC demand.

#### **Inventory**

- matching inventory levels with demand
- understanding of current demand trends
- keeping spare inventory back
- an inventory system in place to meet a sudden rise in demand
- inventory management

## **Distribution/Sales**

- employing direct selling model
- employing indirect selling model
- offering the customization and service capabilities of the retail channel
- outsourcing distribution of non-core business segments that can be done more efficiently elsewhere through alliances.
- setting up distribution centers in key market areas
- providing good customer service to ensure customer satisfaction should problem with distribution arise

## **Customers/Consumers**

### ***Individuals.***

- consumer support with automated on-line centers
- consumer on-site support
- consumer over-the phone support
- the consumer education about the system and options available with it
- delivery services, which can be a strong factor in purchasing a system

### ***Government.***

- providing strong support package with staff available 24/7
- customized web sites created for a specific agency/department
- providing long-term lease options for installed systems.
- providing correct step-by-step installation and delivery

### ***Corporations.***

- capitalizing on combining sales of services and support with products to create affordable value package
- maintaining exceptional service and support to meet all the needs of a company
- Customized web sites to promote the on-line support
- understanding the large-scale needs of corporations
- offering lease options
- on-time fast installation and delivery
- corporate pricing discounts

## **PC Prices**

- competitive/low pricing.
- aggressive pricing to maintain or increase market share.
- sub-\$1,000 systems are successful in raising the penetration of PCs in the home market
- use of direct sellers' methods

## **Internet**

- ability to adapt to market changes.
- e-commerce market penetration
- adapting product mix to on-line sale

- adapting internal practices and business models to on-line sale
- customized user “friendly” web sites for each corporate customer
- on-line automated technical support for individual consumers
- targeting the specific customer groups

## **R&D**

- allocating sufficient resources for effective research
- creating technology that meets customers needs and preferences
- ability to bring new technology to the market before competitors do
- upgrading existing technology in order to diversify away risk of the uncertainty of new technology
- ability to invest large amounts of money into risky new technology
- strategic partnerships and acquisitions.

## **Promotion/Advertising**

- creating brand recognition and brand loyalty through distinction by creative TV ads,
- creating brand recognition and brand loyalty through distinction by creative by using magazine ads
- creating brand recognition and brand loyalty through distinction by creative by web advertising

## **E. Comparative Competitive Position Evaluation**

Dell Computer Corporation’s strengths and weakness are broken down into nine keys to success areas. They are product line, suppliers, inventory, distribution/sales, customers/ consumer, PC prices, Internet, R&D and promotion/advertising.

In the product section, Dell was strongest in Personal Computing and Entry-level servers. This was mainly because of Dell’s ability to deliver to the market the newest technology and upgrading/developing existing technology and offering it with competitive/low pricing. Companies like IBM, Compaq and Gateway performed not so bad in this section, although all of them lost market share, and consequently revenue. IBM did keep its market share in Mid-range and gain some in High-end servers segments, but it was not enough to save revenues. Compaq only performed well in High-end server segment, but the company’s stock had fallen anyway due to the upcoming merger with HP (that didn’t so well in 2001 either). Dell didn’t perform well in Mid-range to High-end segments, because of lack of experience in those sectors and also because Dell associated more with personal computing and workstations, another segment the company performed very well in 2001, than with server segment. Even though IBM, Compaq and Gateway could provide the latest technology for the PC segment, they lacked the ability to accurately assess market and consumer trends, and had higher prices than consumer was willing to pay.

Dell performed very well in both suppliers and inventory sections. In the suppliers section Dell had a clear advantage over the competitors, because of the company’s ability to keep the number of suppliers to the minimum and good relationship that it had with them. Dell also had an advantage in inventory section, because the company was very efficient with its just-in-time inventory system that eliminated duplication of processes, delays and bottlenecks. As a result of being very effective with its direct selling/distribution model and outsourcing distribution of non-core business and manufacturing

segments Dell had a competitive edge over IBM, Compaq and Gateway. However the company had no retail channels, which gave its competitors ability to offer the customization, service capabilities and “feel” of indirect selling/distribution model. Dell still had a way to go to reach IBM’s and Compaq’s ability to set up distribution centers, especially around the world.

In the customer/consumer area, Dell performed better than IBM, Gateway and Compaq. The company increased its sales to individual consumer, government agencies and businesses. Dell was able to do that by offering low prices, by providing customer/consumers with compete pre and post sale services, by understanding their needs and by having effective promotion/ advertising. As a result of being so cost effective Dell was able to continue aggressive pricing strategy by undercutting all of the competition prices and offering lowest rates of any major PC manufacture. IBM, Compaq and Gateway had no choice, but to engage into the price war. Competition lost a lot of marginal profit and market share, because they were not quick enough to respond and follow Dell.

Dell’s weakest point was R&D (so as Gateway). Although the company was good in delivering newest technology and upgraded technology to the market, it depended on others to get that technology. IBM and Compaq had an advantage over Dell and Gateway in upgrading existing technology and latest technological developments. By allocating sufficient resources to create alliances the company should be able to stay on the edge of most advanced technology.

#### **4. EVALUATION SUPPORT**

##### **A. Financial Analysis**

In the second quarter of 2000, US PC shipments rose by just 7% slowing noticeably from the 17% pace set in the first quarter, according to International Data Corporations. By late 2000, demand for PCs had slowed globally: worldwide unit shipments slowed from the double-digit rate seen in the first three quarters of 2000 to 9% growth in the fourth quarter. This failing intensified during 2001. The collapse came in the second quarter of 2001, when worldwide PC shipments actually declined by 2.0% for the first time in the industry’s history [Graham-Hacket, 2001].

Two factors were mainly responsible for the market drop, the first one being the global economic slowdown. The other reason for the slowdown was specific to the PC industry itself. PC demand was coming off of several years of strong growth. Worldwide PC shipments rose by 16% in 2000, 23% in 1999, 13% in 1998, and 16% in 1997. This growth was largely stimulated by global consumer demand for Internet access. The acceleration in 1999 was also driven by system upgrades required to protect against Y2K problems [Graham-Hacket, 2001].

Dell reported an increase in net revenue of 26% in 2001 as compared to 2000. 2000 net revenue was 38% higher than 1999. Strong growth in net unit shipments across all regions and products drove the revenue increase, which was somewhat offset by lower average selling prices. Net unit shipments grew 29% for 2001 and 50% in 2000. The company’s enterprise systems, which include servers, storage products and workstations, continued to build a substantial presence in the marketplace, with unit shipments growing 47% during 2001. Also, notebook computer unit shipments increased 52%, and desktop computer systems unit shipments increased 22%. Unit shipments grew during year 2000 across all product lines as well: unit shipments of enterprise systems grew 81%, notebooks grew 61%



and desktops grew 46% [Graham-Hacket, 2001].

## **B. Financial Analysis Discussion**

By choosing alternative one Dell would continue on the course of squeezing marginal profits by matching and under cutting prices of the competition. That seemed to work that far, but they can't cut costs forever. Alternative two required substantial investment into new indirect approach to distribution/sales and new inventory style. Although the company did possess the amount of cash required for such operation, with economy in recession and sales falling that did not look to be the best way to keep No. 1 position.

Dell possessed many of the key advantages of its competitors that were necessary for success in the PC segment. The company had efficient distribution/sales model, low pricing, broad consumer base and killer just-in-time inventory system, just to name a few. To remain competitive and in the lead Dell had to address several issues, including economic slowdown, falling PC sales and immense competition. Alternative three would allow Dell to utilize its resources in new ways. Using its established positions and strengths the company would tap into the markets that it was pretty much absent from. Server and storage equipment markets were one of the fastest growing markets in the industry. Dell's position there was pretty weak. The company could use that opportunity to get into entry-level and high-end servers market. Entry-level segment would allow company to penetrate market quickly. It would also allow brand recognition in that segment. Furthermore Dell could penetrate high-end servers market to collect on its high profit margins that IBM and Compaq were cashing on for years. With Internet capability and availability continuously having been expanded progressively storage equipment became one of the most important products on the market. And since there was not foreseeable end to the expansion, investment and penetration into storage equipment segment was good long-term asset. Dell had to also take a look at their global position. The company had strong presents in Europe. However there was so much potential in regions such as Asia-Pacific and South/Latin America. Those areas had demonstrated prospective for fast growth and development, which meant more market share and sales for the company. In the atmosphere of intense competition Dell decided pursue aggressive pricing strategy. By undercutting price of competitors the company became the only PC manufacture to gain market share in 2001. Also Dell finally decided to address the weakest point in the company – R&D. To stay on the edge of technological development it was decided to acquire several smaller companies, special attention was paid to storage equipment firms.

## **C. Competitive Scenario Analysis**

Given Dell's decision to aggressively expand internationally and into the new markets, IBM, Compaq, Gateway and others would be certain to respond. By increasing market coverage the company would improve its global position that would lead to obtaining more market share. By expanding into the new markets, such as servers and storage equipment the company would diversify the risk of depending on only certain line of products. IBM, Compaq and Gateway would enact certain strategies in order to ensure their current and future positions on the market. There could be several ways for them to archive that. One strategy could be to match Dell's prices and play on brand loyalty to maintain their current customer base and attract new ones. Other strategy could be to put out on the market more advanced systems while increasing advertising and promotion to educate the consumer in superiority of their product. They could also try to cut costs by discontinuing their retail operations as

IBM did in 1999. Furthermore competitors could attempt to outsource some manufacturing and distribution functions. No matter what course of action competitors take, they should do it fast as Dell continuous to take away their market share and sales.

## **5. REPORT ON THE CASE STUDY**

### **The Company**

Based in Austin, Texas, Dell Computer Corporation was the leading direct seller of computers in the world. Dell takes orders over the phone and through its web site. Dell assembles a computer specifically for each order, making and shipping a PC usually takes less than 36 hours. Custom-building computers according to each order means Dell can respond rapidly to the changing needs of the marketplace. Dell was the first PC maker to offer direct, toll-free technical phone support and next-day, on-site service. In July 1994, Dell discontinued retail channel sales to focus exclusively on its direct business. As of the first quarter of calendar 2001, Dell was the world's largest PC maker, surpassing Compaq Computer, and also maintained its leadership in the US, according to market researchers [Standard & Poor, 2001].

### **Products**

The company designs, develops, manufactures, markets, services and supports a wide range of computer systems, including enterprise systems (servers, storage products and workstations), notebook computers and desktop computer systems, and also offers software, peripherals and service and support programs.

Dell's line of enterprise systems (19% of 2001 system net revenues, compared with 17% in 2000, and 13% in 1999) includes workstations and servers. Dell's PowerEdge servers are used in networked environments to distribute files, database information, applications and communication products. Dell's new PowerApp Servers are new appliance servers aimed at Web-related workloads. After entering the market for Windows NT-based workstations in early 1997, Dell quickly became the world's leading supplier.

Desktop computer systems remain the largest segment (52% of 2001 system net revenues), and include the OptiPlex line, targeted at corporate and other major account customers, and offering advanced features and high reliability; and Dell Dimension, targeted at small to medium-sized businesses and individual users.

Dell's higher margin notebooks, or portables, provided 29% of system net revenues in 2001, and include the Latitude product lines, for corporate users, and the Inspiron line for consumers and small businesses.

Dell also offers thousands of software packages and peripheral products through its DellWare program. Dell services include software integration and network installation and support. Dell's services grew 659% in its 2001 fourth quarter, reaching \$785 million [Yahoo, 2001].

### **Additional Services**

Dell was active in the services business. Challenging such companies as IBM with global Services' dominance. "That's a big piece of the pie that Dell doesn't have much of," said Roger Kay of IDC, the IT consultancy. But Dell did not go head to head with IBM's services unit. Just replicating IBM's services capabilities would take "an incredible amount of time". The emphasis was on strengthening services that are related to or supportive of the products business. And when it comes to large consultancy or integration projects, Dell continued partnerships with services groups such as EDS, Accenture or Cap Gemini [Standard & Poor, 2001].

## **R&D**

One of the biggest weaknesses of Dell Computer Corporation was that it has to rely on R&D of others to manufacture their own products and services. R&D was completely absent as a part of the corporation. To start its own R&D department Dell would need to spend a lot of cash and, considering slow economy and falling profit margins, that was not a good idea at the moment. The best bet was to ally itself to the company with a strong R&D present or buy such a company. The company had successfully developed cooperative and working relationships with many of the world's most advanced technology companies. Working with these companies, Dell's engineers managed quality, integrated technologies and designed and managed system architecture. This cooperative approach made it possible to determine the best method and timing for delivering new technologies to the market [Graham-Hacket, 2001].

## **Customer/Consumer**

Dell sells primarily to medium- and large-sized businesses and government agencies, though increasingly the company was targeting the consumer market. The company derived nearly two-thirds of its business from large businesses and government entities [Yahoo, 2001].

## **Distribution/Sales**

Dell's direct sales model and tight cost controls left it in the good position to survive the industry slowdown. The strategy not only allowed the company to take prices to low-end extremes, but also gave it tremendous flexibility. The direct model allowed it to quickly adjust its offerings in accordance with demand through rapid product change. More importantly, product transitions did not leave it stuck with useless inventory. While price cuts were helping Dell gain market share, they were not the ones that drive PC demand: the market share gains are coming at the expense of the competition, not industry growth. As such, Dell's reduced cost structure also reflects slowing industry growth prospects [Graham-Hacket, 2001].

At the heart of those characteristics was Dell's unique direct-to-customer business model. "Direct" refers to the company's relationships with its customers, from individual consumers to the world's largest corporations.<sup>2</sup> There were no retailers or other resellers adding unnecessary time and cost or diminishing Dell's understanding of customer expectations. Today, a custom order placed at 9 a.m. on a Monday can be on a delivery truck by 9 p.m. Tuesday. What's more, this speed had allowed Dell to slash inventories and keep parts costs down so low it can under price its rivals by 10% to 15%.

Dell had long been a model of just in time manufacturing, but it had raised the stake by applying the same brutal time standard to its supply chain, insisting, for example, that the bulk of its components be warehoused within 15 minutes of a Dell factory. Dell also had seized on the ultimate in low-cost, fast-paced business - electronic commerce. The combination puts Dell in the front line of manufacturers in any industry [Graham-Hacket, 2001].

## **Production/Operation**

The company dealt with hundreds of suppliers, but about 90% of its parts and components came from two dozen companies. And it worked closely with them to make sure the parts were designed for snap-in assembly and just-in-time delivery to its factories. It has provided the lowest overall cost to the customers, and since the cost structure is less than half of competitors'. As a result, Dell has one integrated process for managing the entire value chain, from component supplier to end customer - and they control all the aspects in-between.

Dell had long been a model of just-in-time manufacturing, but now it had raised the stakes by applying the same brutal time standard to its supply chain, insisting, for example, that the bulk of its components be warehoused within 15 minutes of a Dell factory. Dell also had seized on the ultimate in low-cost, fast-paced business - electronic commerce. The combination puts Dell in the front line of manufacturers in any industry. "If you're good at both, you get a multiplier effect," said Robert E. MacAvoy, president of Easton Consultants, a Stamford, Conn. management consulting firm. "That is Dell" [Burrows, 2000].

## **Financials**

Dell experienced growth in net revenue worldwide during both fiscal years 2001 and 2000. The company reported an increase in net revenue of 26% in fiscal 2001 as compared to fiscal 2000. Fiscal 2000 net revenue was 38% higher than fiscal 1999. Strong growth in net unit shipments across all regions and products drove the revenue increase, which was counterbalance by lower average selling prices. Average revenue per unit sold in fiscal year 2001 decreased 2% compared to fiscal year 2000, which was due to price reductions as a result of component cost declines. Average revenue per unit for the fourth quarter of fiscal 2001 was approximately 6% lower than the full year average as Dell used its direct-to-customer model to drive profitable market share growth. Management currently expects that this aggressive pricing environment will likely continue for the near future as the company and its competitors adapt to slowing demand and general softness in the overall economy. Average revenue per unit sold in fiscal year 2000 decreased 8% compared to fiscal year 1999, which mostly resulted from the aggressive pricing strategy [Graham-Hacket, 2001].

## **ALTERNATIVE CORPORATE OBJECTIVES**

### **Alternative 1**

Dell would pretty much maintain the same manner of doing business. The company will focus on the current product line. The company will choose to keep same distribution/sales channels, not to get in R&D expansion (upgrading existing technology only) and maintain same base of customers/consumers. Dell will utilize printing media as well as television to promote itself, its

products and services. Being very efficient at just-in-time inventory there will be no reason to make any changes there. The company will also keep market coverage to the minimum with US and Europe being main drivers of profits and just expanding to South America and Africa. Since Dell already established itself as a leading computer hardware manufacture there will be no reason to undercut competitors' price wise, just match their prices.

### **Alternative 2**

Alternative two will bring some fundamental changes in the ways Dell conducts business. Giving that Dell already established itself as a leading computer hardware manufacture it will go for high-end systems with higher prices than competition battling that customers/ consumers would be loyal to the brand and stick with it. It will also improve some secondary services that go hand to hand with delivery and installation of Dell's products. Dell will also decide to go back to retail channels in order to penetrate more conservative consumer (touch, feel, smell before buy type of consumer). With retail channels as a distribution channel the inventory system would have to change to stock inventory. Moderate acquisitions to get some R&D momentum will be authorized. Furthermore considering leading role of Dell, it will be able to cut down on promotion/advertising solely focusing on TV ads in already established areas such as US, Europe and Africa, as well as concentrating on South Asia and China.

### **Alternative 3**

Dell possessed many of the key advantages of its competitors that were necessary for success in the PC segment. The company had efficient distribution/sales model, low pricing, broad consumer base and killer just-in-time inventory system, just to name a few. Using its established positions and strengths the company would tap into the markets that it was pretty much absent from. Server and storage equipment markets were one of the fastest growing markets in the industry. The company could use that opportunity to get into entry-level and high-end servers market. Entry-level segment would allow company to penetrate market quickly. It would also allow brand recognition in that segment. Furthermore Dell could penetrate high-end servers market to collect on its high profit margins that IBM and Compaq were cashing on for years. With Internet capability and availability continuously having been expanded progressively storage equipment became one of the most important products on the market. And since there was not foreseeable end to the expansion, investment and penetration into storage equipment segment was good long-turn asset. Dell had to also take a look at their global position. The company had strong presents in US and Europe. However there was so much potential in regions such as Asia-Pacific and South/Latin America. Those areas had demonstrated prospective for fast growth and development, which meant more market share and sales for the company. In the atmosphere of intense competition Dell decided pursue aggressive pricing strategy. By undercutting price of competitors the company became the only PC manufacture to gain market share in 2001. Also Dell finally decided to address the weakest point in the company – R&D. To stay on the edge of technological development it was decided to acquire several smaller companies, special attention was paid to storage equipment firms. No. 1 position will encourage Dell to increase spending on promotion/advertising and focus on a mix of printing media, web ads and TV ads following a common concept.

## EVALUATION AND DECISION

### Alternative 1

Dell will continue to focus on a full range of current products and current services. It was predicted that economy will be on rebound in 2002, which will bring up sales and profits as spending on IT sector would go back to the original level or even increase. Dell's low operating costs provided cost-effective products and services and helped to gain market share when nobody else did. Basically it comes down to Dell do what it does best – be efficient and save money.

The **benefit** of this alternative is that no major changes will occur; Dell will be essentially maintaining its current operations while using its momentum to gain even more market share. So far the company remained profitable, not even economic slowdown could hurt Dell. Based on that management could assume that they are on the right track. Dell will continue to gain market share and increase sales.

The alternative is **feasible** because it is pretty much the same way Dell does business now, so no major investments or infrastructure development/changes are needed. The company is stable financially and no additional financing would be needed, so whatever minor changes might needed to be done Dell could raise the money by itself.

The major **drawback** is that in computer hardware industry, or any business of that magnitude for that matter, change and expansion are absolutely necessary for survival. "If it's not broken don't fix it" type of attitude in business might and will eventually bring company's downfall. If Dell would continue squeeze profit margins without diversifying into other segments, it will eventually hit the point where there is no more squeeze, which will affect sales and profits. Company's present markets are maturing and difficult to operate in. The old "market proven" strategy may actually intensify the risk during times of decline in sales. It will also limit Dell's potential for the future profits.

**Ways around this drawback** is to concentrate on direct distribution and just-in-time inventory to cut costs and match low end of competitors price range, increase market share in US and Europe, outsourcing certain manufacturing functions and ensuring that customers/consumers have one-stop solution for all of their product and service needs. Relocate money that would have been invested in R&D to increase promotion/advertising spending. With increased brand awareness and recognition Dell can expect to gain more market share and profits.

This alternative can **win against the competition** because it was successful in delivering what the customer wants and needs in package that brings satisfaction beginning from quality of products to delivery and instillation to maintains and support. Dell will continue to take away market share from its competitors by providing complete solution as a result of strict control of operations and flexibility to respond to the changing environment.

### Alternative 2

Alternative two will bring some fundamental changes in the ways Dell conducts business.

The **benefits** of this alternative are that Dell will be focusing on its most profitable segments with high profit margin. The company will also improve customer satisfaction by providing extended services to develop long term relationship. It will also be able to access to even broader customer base, because the company will employ retail channels for distribution and sales. Another **benefit** is that company will diversify the risk associated with market saturation.

This alternative is **feasible** because Dell is in good financial health with free cash available for investment. The company has a loyal base of customers who are willing to pay more as long as they get the quality and satisfaction that comes with Dell's name. It's also **feasible** because Dell would concentrate on one particular segment.

One **drawback** to this alternative is the process requires a lot of money to be invested. Money that can be used somewhere else, for example opening another distribution center in China. Another **drawback** is that, because Dell going back to retailing, it has to stock the inventory, which will bring up operating cost consequently taking away from profits. Furthermore Dell would cut back on promotion/advertising focusing primarily on TV ads and ignoring the rest of the media, to try to balance out losses, as a result brand recognition and awareness will suffer tremendously. Another major **drawback** would be high-risk exposure Dell faces after opening retail chain, especially in market that already saturated or maturing. It is also possible the majority of customers will reject an idea of paying more for something they might never use.

The **ways around these drawbacks**, include acquiring few companies to ensure Dell's technological sophistication by providing only the latest that technology has to offer and expanding internationally to such fast growing markets as South Asia and China. Relocate money that would have been invested in promotion/advertising to increase R&D spending, which would lead to better quality products.

In order to **win against competition** Dell will diversify itself by employing retail channels to distribute/sell its products and services, by expanding into new international markets, by focusing on the most profitable customers who are willing to pay more for getting the best there is. In order to **win against competition** in technology Dell will acquire companies with strong R&D potential. By focusing on the most profitable segments Dell will continue to win against the competition.

### **Alternative 3 – Chosen Alternative**

The chosen alternative for Dell Computer Corporation is Alternative 3. Dell should continue to expand its product line into servers and storage products markets. Services should be expanded into area of enterprise services, such as planning, implementation, optimization and consulting. Services will be big growers when the economic rebound brings corporate information technology spending to more normal levels, and clients can afford to build more customized systems around their PCs and servers. It is also important to expand into international markets that growing faster than US. Dell has no presents of their services in the international arena. It is very important for Dell to keep the alliances and create new ones in R&D area. Since company does not have its own R&D department it needs technology of others to stay on the top.

The **benefits** of this alternative are that with further expansion of the Internet, e-commerce and data warehousing servers and storage equipment became the fastest growing segments in computer hardware industry. It requires a lot of investments and strong R&D, but in long run it more than worth it. By being efficient as ever through use of cost control, direct distribution and just-in-time inventory Dell can offer lower prices than the competition. Another **benefit** is that the company will be focusing on most profitable segment, there is a high growth potential in server and storage equipment segments, and Dell will able to cut costs and increase its competitiveness through alliances and acquisitions in R&D area. It will attract more customers and increase market share. Additional **benefit** is growth/expansion opportunities in the global markets.

The alternative is **feasible** because Dell is well known for its ability to focus on the given objective and be efficient in fulfilling it. Since Dell was the only PC manufacture to profit in 2001, it has financial backing it needs to further invest into the segments without boring money from outside. Outsourcing through creating well thought out and mutually beneficial alliances and acquisitions will greatly benefit the company. Dell also has some experience with expanding internationally.

One **drawback** to this alternative is that lower prices would bring low profit margin and potentially could drain Dell's cash resources. Another **drawback** is that by concentrating all efforts on only few segments, other segments might get neglected. Additional **drawbacks** include vast amounts of money has to be invested into R&D; outsourcing of R&D requires giving up certain level of control and decision making; identifying appropriate global markets for expansion.

There are several **ways around drawbacks** such as diversifying product line and services to minimize the risk, expand internationally into the new, fast growing markets, for example Asia-Pacific, and South/Latin America; by offering lower prices increasing market penetration and brand recognition, so will brand loyalty; by incorporating and allying the company with firms that have strong background in R&D and radical new technologies; by creating brand awareness and recognition in international markets.

In order to keep the leadership position and **win against the competition** Dell will have to incorporate aggressive pricing strategy, expansion strategy, cost cutting strategy and increase in expenditures on promotion/advertising into one single policy. The company will continue to focus on its PC segment. The company is a global leader and has been successful in gaining market share and profits and been cost effective. It is important for Dell to be able to create or possess technology that can work across different standards. If Dell wants to a leader in the industry, the company will create systems that are open to development and enhancement. New technologies are being developed in the industry and it is important to have ability and infrastructure that will be able to support these new innovations. The alliances and acquisitions will allow Dell to increase its profits in segments the company is new to. By outsourcing Dell will be able to get a new approaching to the design and production, reduce coast and win over competitors.

## 6. THE SUMMARY WINNING STRATEGY STATEMENT

Excellent value, a combination of price, quality, and service – is a winning strategy for Dell. However, the company is facing uncertain future with economic recession still continuing and markets



maturing. In order to differentiate itself from competition, Dell's strategic decisions will focus on aggressive pricing strategy and expansion into new markets and globally. Dell's ability to deliver high quality products and services will continue drive its profits up. The company will diversify its dependences on one particular line of products and services by engaging and investing into the new segments.

Price competition had been the characteristic of the PC market. Direct sellers had been able to under price indirect sellers, which sell through retail channels. This is because direct sellers yield savings by maintaining low inventory levels. In addition, they didn't have to pay the incentives or price guarantees that indirect sellers typically pay resellers. In addition, Dell have tried to increase the sales price of each PC sold by offering software, peripherals, financing, and other services to customers. The efficiencies that Dell gained from maintaining low inventories have become critical to achieving profitability in the PC market. This became even more important when PC makers experience periods of dramatically lower prices for components such as microprocessors and memory chips. Dell needs to maintain low inventories so it can take advantage of sharp price declines for these components. If company doesn't, its competitors can more rapidly reduce PC prices to reflect lower component prices.

Acquiring companies will greatly benefit Dell as a long turn investment that brings newest technology to the table. Acquisitions give Dell the business expertise that it will not be able to gain quickly by any other method. Alliance strategies provide the short turn flexibility to respond to changing technology demands and quickly gain expertise in new emerging technologies. Alliances enable Dell to maintain independence necessary for enforcing its own policies. As new and more complex technologies are introduced, this ability to understand and work with any system will prove to be of enormous value customers/consumers.

Overseas expansion into Asia-Pacific and South/Latin America is viable because ever increasing sales to those geographic areas. As the US market matured, Dell will be looking abroad for faster growth rates. Consequently, Dell has to be able to compete on a worldwide basis; this required substantial investment in global manufacturing and distribution infrastructure. As the PC industry became more global, Dell will increasingly pursue outsourcing relationships when it is economically feasible and when it reduce the time needed to get a product to market.

<b>KIND OF DECISION</b>	<b>1</b>	<b>2</b>	<b>3</b>
<b><u>Product</u></b>	Servers Storage products Desktops Notebooks Services Software Peripherals Equipment Workstations	SAME, but with focus on high-end products. Plus Improve Extended Services, such as maintenance & support (PC, network management) to develop long term relationship	PC products: Servers Entry-level High-end Storage products  Develop Services: Consulting and Training services System Integration services, to develop long term relationship
<b><u>Distribution/Sales</u></b>	Direct Distribution only	Direct & Indirect Distribution	Direct Distribution only
<b><u>R&amp;D</u></b>	NONE	Moderate Acquisitions	Alliances & Acquisitions
<b><u>Customers/Consumers</u></b>	Individuals Government Small Corporation Medium Corporation Large Corporations	Government Medium Corporation Large Corporations	Individuals Government Small Corporation Medium Corporation Large Corporations
<b><u>Promotion/Advertising</u></b>	Mix of printing media and TV in all markets	Focus on the television.	Mix of printing media, web ads and TV ads
<b><u>Inventory</u></b>	Just in time inventory	Stock inventory	Just in time inventory
<b><u>Market Coverage</u></b>	USA and Europe	US, Europe, Africa, South Asia and China	USA, Europe, Asia-Pacific, South/Latin America
<b><u>PC Prices</u></b>	Matching the Competitors	Higher prices than Competitors	Lower prices than Competitors

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## **Disassembling the Team at Vanguard Electronics**

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### **ABSTRACT**

In this case, Vanguard altered part of its structure through the development of teams in order to maximize its operations; and given their results Vanguard successfully put theory into practice. The critical issue in the case is the firm's ability to continue using teams in light of the fact that their internal change agent has left the organization.

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“Wendy have you seen the new performance figures for the Assembly Department,” said Jim Glass, Vice President of Manufacturing. “They’re horrendous! When Mike was there the numbers were fine, even improving, but now since Shari has taken over...What did we do wrong? Could we have done anything differently?”

### **Background**

Vanguard Electronics was a global electronic and electrical engineering leader. Founded in the early 1900s by Gert Von Gaat and Carl Juda, as a telegraph company, they soon found the need to expand out of Germany's borders to support their telegraph systems. Vanguard Electronics changed over the years in their diverse product line and the way they do business. It was reshaped recently into an “e-company” to be more agile and responsive to its customers. Since 2000, the Company spent approximately 1 billion dollars in e-business initiatives to make their new products and services accessible to customers anywhere in the world. Annually, Vanguard Electronics spent 5 to 6 billion dollars on global research and development investments.

Vanguard Electronics did not get to be a world leader and corporation of its size without a sound strategy, and continual evaluation of plans and activities. The board of directors in Germany, monitored all of the divisions of Vanguard Electronics, and provided the vision, mission statement, and goals for the Company. Aside from the Telecommunications Division, the Company also manufactured medical equipment, automotive parts, hydro electrical machinery, computers and electric commuter trains.

Vanguard Electronics had a presence in more than 190 countries, with 460,000 employees worldwide. The United States alone had some 700 locations and nearly 80,000 employees. Through product growth and acquisition plans, Vanguard Electronics grew to be one of the largest companies in the world.

Gert Von Gaat was quoted in 1910, "I will not sell the future for a quick profit." Obviously, he wanted to provide his customers with the best product possible. Given this emphasis on quality, a plan for globalization was developed. The strategy was not for market dominance but for the creation of a quality niche. For example, in the field of telecommunications the niche was for product engineering and knowledge. The brightest minds and resources in the telecommunications field were in the USA, but due to trade laws, a company could not compete in the US market unless their product was at least assembled within the borders of the country. To accomplish its plan for globalization and to satisfy the US regulations, Vanguard, in the 1990s, bought smaller US companies.

In 1987 Vanguard Electronics bought the Byte Company located in New York and started building its telecommunications switch in the USA. In 1998 Vanguard Electronics merged with Stromboli Telecommunications in Florida and moved its manufacturing facilities there. The merger of the two telecommunications giants was not easy or smooth but it was necessary in

order to compete with Nortel and AT&T. In 2001 the company changed its name to Vanguard Electronics.

### **The Team Concept in the Systems Test Department**

The force of technological change drove Vanguard Electronics' success for 100 years. Vanguard Electronics was very active in accepting new ideas on raising funds, training their employees and development of advanced product concepts. Encouraged by this philosophy, in 1999 the director of the Systems Test Department, Mack Ramsey and his manager Mike Wesley decided to implement a team environment in the Systems Test department. The idea of going to a team environment with empowered employees came about as a way to combat the growing morale problems faced as a result of the downsizing process that most of the manufacturing field had been implementing to cut costs.

The original structure of the Systems Test department was the typical "top down management" style used in all manufacturing organizations (See Appendix A, Department Organizational Chart.) It had 28 Technicians on two shifts, which ran test equipment 24 hours a day seven days a week, all reporting to the manager and the manager reporting to the director. All activities within the department were controlled and monitored by management. The technicians' responsibilities were to test the telecom systems. Mr. Wesley was responsible for creating the test schedules, monitoring the test yield and quality processes, attending all meetings concerning the department, calculating the efficiency and productivity for the department, implementing process improvements and managing the human resources. The empowered team concept organizational structure was built around three teams each headed by a team leader who reported to the "coach", Mr. Wesley (Appendix B Team Organizational Chart.)

## **Team Emphasis**

None of the participants including management had experience with teams nor did they have any training when the new structure began. Classes were set up at the training center and were conducted by Human Resources instructors. Each member of the department received a book on empowerment and was asked to read it and provide feedback. The classes that Human Resources provided were empowerment and interpersonal relationship skills training. At first there was reluctance on the part of the technicians, some of them felt they had enough work to do already and didn't want any added responsibility without added compensation. The classes helped to show the employees how the team environment worked and that the added responsibility was a benefit to them not a hindrance.

The three teams were split by product type and shift coverage. There were two types of systems that Vanguard Electronics manufactured in the Florida facility. One was the Digital Central Office (DCO) and the other was the Electronic Switching Devices (EWSD). Both DCO and EWSD were electronic telecommunications switching networks, DCO being the Stromboli model and EWSD being from Vanguard Electronics. On the day shift there were 7 people who worked on the DCO product and 12 that worked on the EWSD and on the night shift there were 9 people who worked on both product lines. These three teams each were headed by a team captain. Richard Spikes was team leader for the DCO team, Mike Murdock was team leader of the EWSD team and James Runyon was the team leader of the night shift team. At the outset, all personnel agreed with the choices of team leaders and the team format provided.

## **Implementing the Team**

Once the teams were set up and training was given, the process of working as a team was started. Mr. Wesley gave out assignments for each team member so that each member was also a member of a “sub” or lower level team. The daily responsibilities for running the department were given to the team members. For example, Jeannette Nelson was responsible for the scheduling of the DCO product. She met with the other “schedulers” on the other teams and went to the scheduling meeting held with planners and purchasing to assure that all material would be available for the production schedule. Evans Etienne was given the responsibility of tracking and monitoring the yield and quality of the EWSD product line and met with the other quality team members and with engineering and quality department representatives. Mr. Wesley worked with each team member to assure that they were properly trained on the processes and that they were on the right track before letting them on their own in the decision-making process. It was a slow process but eventually Wesley’s responsibilities shrunk and the teams took on more and more.

Another important sub-team was the Morale Team. Wesley felt that morale was at an all time low, and it was this feeling that was one of the driving forces behind going to the team concept in the first place. Noticing that not all of the technicians were as excited as he was for this new process, he decided if he had a team of “cheerleaders” promoting the team concept process and at the same time asking for opinions and suggestions for improvement, it could help to get everyone on board. That was the Morale Team’s function.

All team members also had the opportunity to rotate responsibilities after some time had passed so they would be able to try their hand at the different aspects of the manufacturing processes. These moves were agreed upon by the members and the team found it helped members to find their comfort zone within the teams. Each team was responsible for the



following: Scheduling, Quality, Floor Plan, Training, Maintenance and Calibration, Team Leader, Documentation, Morale and Process Improvement.

### **The Mechanical Assembly Department**

After 2 years the teams were functioning rather smoothly and taking on most of the responsibilities of the department. Mr. Wesley spoke with his director about the progress of the teams and how his role as coach now left him with a lot of free time. Wesley requested more work and responsibilities and this occurred at the same time when Mr. Glass was planning to restructure all Manufacturing departments. Wendy Kiefer, who was the Director of Master Scheduling, was given the Assembly and Test Departments and Mack Ramsey was moved to the direct the Boardline production (a new Company project). Mike Wesley was now manager of the Mechanical Assembly Department and still was coach of the Systems Test Department. When Wesley took over the Mechanical Assembly Department in December of 2001, he immediately started preparing to implement the team environment in that department. Having the success of the Systems Test Department to back up his proposal for teams in Mechanical Assembly, he went to Wendy Kiefer to get approval to start teams. Wendy was in full support of teams and gave the approval to get started.

Later, Wesley was told in confidence that some management felt that the team concept would not work in the Mechanical Assembly Department because there were so many processes in building the different systems, the department was too large, and most importantly, the employees didn't have the education required to handle all of the aspects of empowerment.

When Wesley spoke to the employees within the department they had mixed reactions to the team concept. Half were excited because they had seen what it had done for Systems Test and

wanted to experience some of the freedoms that went along with the team environment. Others didn't want the added responsibilities and felt they didn't have enough time to commit, and there were some who felt it wouldn't work because they wouldn't be able to get everyone to carry the work load evenly. After going over all of their concerns Wesley told Wendy Kiefer that most of the problems cited were the same things the technicians of Systems Test had stated at the beginning and that it was worth the risk. He decided that he was going forward with starting teams in the Mechanical Assembly Department.

Just after start up, Wesley was told by Jeannette Nelson, who worked in the Pad Mount area, that the people in Mechanical Assembly felt that it was just a "Wesley project" and when he was replaced, in a year or so, the teams would stop when a new manager came in, so "why bother working harder on a team." What Mr. Wesley didn't realize, before taking over, was that although he had been in Systems Test for 10 years as supervisor and manager, the Mechanical Assembly Department had no less than 7 different "bosses" in the same time frame. He knew he needed upper management's support for the team concept, and for upper management to broadcast their support to the people of the Mechanical Assembly Department so they wouldn't think it was "the flavor of the month." He also asked the Morale Team from Systems Test to help encourage the people to accept the project. The Morale Team talked with the people informally and then through a brainstorming meeting came up with a department newsletter.

### **The Peoples' Paper**

The newsletter (The Peoples' Paper), which was conceived of and designed completely by the Morale Team of Systems Test, was published monthly and explained in the Team's words what each team responsibility entailed as well as progress reports from the teams. The newsletter also contained articles and fun facts about manufacturing. The first month introduced the Morale

Team and told what they were about and what they wanted to accomplish. Subsequent issues featured the quality team and introduced all the team leaders. Each issue also had a section called the “Coaches’ Corner” where the Morale Team would interview upper management on an aspect of the team concept or manufacturing processes and put their views in writing. Each person that was interviewed for the paper was asked “what they thought about the team concept?”

### **Team Organization in the Assembly Department**

Mr. Wesley got together with the Test Department and also asked for their help in building up the teams in the Assembly Department. He created the structure for the teams in Assembly and asked that the test personnel work with the assemblers to get them going. So the schedulers from Test worked with the schedulers from Assembly, the quality people from each department worked together, and so on. There were 30 people in the Mechanical Assembly Department all working on first shift and they manufactured the shelves, racks and pads that held the telecommunications systems. The teams were divided by process rather than product type, since the process flow was pretty much the same for all product types. The teams were: Backplane & Sub-Assembly, Rack & Frame, and DCO & Pad Mounts. All three teams were pretty even at approximately 10 people per team and within those three teams they were given the same responsibilities as the Test teams, which included scheduling, quality, floor plan, leadership, morale and documentation. Cindy Washington was the team leader for Backplanes and Sub-Assembly, Julio Roman was leader of the Rack and Frame team and Tom Mahan was team leader of the DCO & Pad Mount team.

After the teams were organized in Assembly the first glitch hit the department. Revenues for the quarter were down and upper management did not allow Mr. Wesley to send the teams through teambuilding training or allow him to buy books for the Assembly Department as he had done with the Test Department. The bad timing made it seem as though management didn't want to support the team project. However, the Test Department helped out by lending books and helping the assemblers learn the new processes and responsibilities. The Assembly department started up the teams without formal training.

After a few months the three teams were operating on their own and progress was being made. Patty Sellers, a member of the Floor Plan team for the Assembly Department, when asked about the new team environment and how she felt about it said "People want the opportunity to work as a team and with a little more training I know we can do it." Coach Wesley now left Systems Test on its own and devoted his full attention to the Assembly Department over the next year. Department meetings were held every other week to discuss issues and boost morale. Wesley attended all of the sub-team meetings that he could to help out and give direction. Process improvements and progress in other areas were listed in the monthly newsletter and were as follows:

- Quality team: "Established a current and active defect database on our computers. At this time the team is trying to correct vendor defects in the Pad Assembly area."
- Scheduling Team: "The efficiency is up to 95%, the highest ever. Housings and Frames were on schedule and we did not miss a shipment."
- Floor Plan team: "We have set up a computer and phone drop at pole L1 for department 10290 (Assembly Department.) We are presently freeing up floor space to make us more efficient and productive."

- Morale team: “Recognition awards were given out. Department 10292 (Systems Test) won the attendance challenge for May. Put together a department bowling party.”
- Documentation team: “The LTGK test procedure and work instructions were updated. Presently helping to make changes to the Accessions test procedure.”

### **Evidence of Empowerment**

These excerpts from the monthly paper indicated that the people on the teams were talking about efficiency, productivity, cost savings, on-time scheduling and recognition. Prior to the teams being created the workers would not talk about these matters, or if so, not in a positive manner. They became empowered and grew to accept the responsibility for all of the processes and actions that go into running a manufacturing facility. The cost savings to the company for their efforts were: throughput time reductions, a reduction in floor space by 20% in 2001, improvement in efficiency to 95 % for the month of June, reduction in supplier defects, which reduced time lost returning parts, and all processes involved in the manufacturing of those parts. According to Mack Ramsey “The cost saving to the company more than outweighed the cost of implementing the teams.”

Although the two departments ran on their own using the team approach and there were many improvements in their work flow and cost savings, not everything was positive for the teams and the manufacturing environment. One problem that they ran into was that the other departments within manufacturing were asking why the Assembly and Test Departments were given privileges and their departments were not. They wanted to know why they didn’t have a voice in their process changes, or why they didn’t get recognition rewards for the job they were doing. Other supervisors and managers were not happy that these teams were empowered to attend

meetings and make their own decisions concerning processes and scheduling of product. And as mentioned earlier, Mr. Wesley was called to a meeting to speak with the Vice President of Human Resources, Mr. Perry and Mr. Glass, the Vice President of Manufacturing about the newspaper.

Their concern about the newspaper involved a few things: first they didn't like that the editor of the newspaper always made religious remarks and comments; secondly they were concerned that it didn't make clear that it was only a paper for the two departments and that the opinions within the paper were only of the editors view and that of the two departments. Mr. Perry mentioned, "the listing for anniversaries of time with the company didn't mention other people within manufacturing who had reached 25 years or more." And finally they were concerned with the title and purpose of the paper, more specifically that "The Peoples Paper" would be considered the beginnings of a Union movement to rally the people against the company. They suggested that although they liked the paper and all the accomplishments of the teams, they should consider changing a few things and reminded them that ultimately the management of the company had the final word on how the company was run. In July of 2001 the newspaper's name was changed to "Carrier Waves" which referenced the telecommunications product more than the people in manufacturing. There were no references to God or religion in the paper.

During the meeting with Wesley, both VP's said that they had put money in the 2002 fiscal year budget for training of all personnel in the manufacturing area and that all departments would be changed over to the team environment starting from the top down. Training for Directors and VP's was already scheduled for August of 2001.

Aside from the few bumps in the road to empowerment, the two departments were on their way to accomplishing what Mike Wesley had said they would. They both were running more

efficiently, attendance was up and cost was down. Contrary to the opinion of some upper management, the Assembly Department was functioning using the team approach and was operating with less supervision. In a short period of time they made significant improvements to the Department. Cost savings and improvements included:

- streamlining processes and better awareness of scheduling, reduced throughput time for assembly and test flow from 9 days to 5 days.
- Improving supplier quality of parts to the Assembly area. Employees gave feedback to suppliers personally.
- Increased efficiency ratings for Manufacturing and Test.
- Decreased overall floor space by 20% in 2000 and continued decreased in 2001.
- Updated test and assembly procedures and work instructions.
- Increased attendance due to competition involving both departments.
- Improved morale through departments, including appreciation awards given by peers to fellow employees.
- Reduced headcount. Reduction of one manager and employees who left or were let go and not replaced.
- Increased cross training and continued training and education (all employees were computer literate by end of 2001 and had access to computers in the work area for documentation and e-mail purposes).
- Increased employee responsibility.

### **Wesley's Resignation**

Due to personal reasons, in September of 2001, Mike Wesley decided to leave Vanguard Electronics to pursue career advancement opportunities with another company.

When Wesley gave his resignation notice to Ms. Kiefer and Mr. Glass he asked that the team approach be given priority when deciding who would be the replacement manager of the Assembly and Test Departments. They discussed the successes of the teams and future plans for all manufacturing departments being empowered. When the meeting was over, both Mr. Glass and Wendy Kiefer seemed enthusiastic about the future of the two departments and team concept. Wesley started planning for his departure and had a Department meeting to tell his teams of his resignation. During that meeting he emphasized the fact that they were now empowered and they should never let that power be taken away from them. He felt strongly that if they continued as teams that no matter who became manager of the departments, that person would have to support the team project and let the employees continue to make the decisions and be responsible for the manufacturing processes. He discussed their accomplishments and how proud he was to be a part of the first successful use of teams in manufacturing at Vanguard Electronics. He also let them know that Jim Glass and Wendy Kiefer were backing the project and urged them to continue on.

### **The New “Old” Appointment**

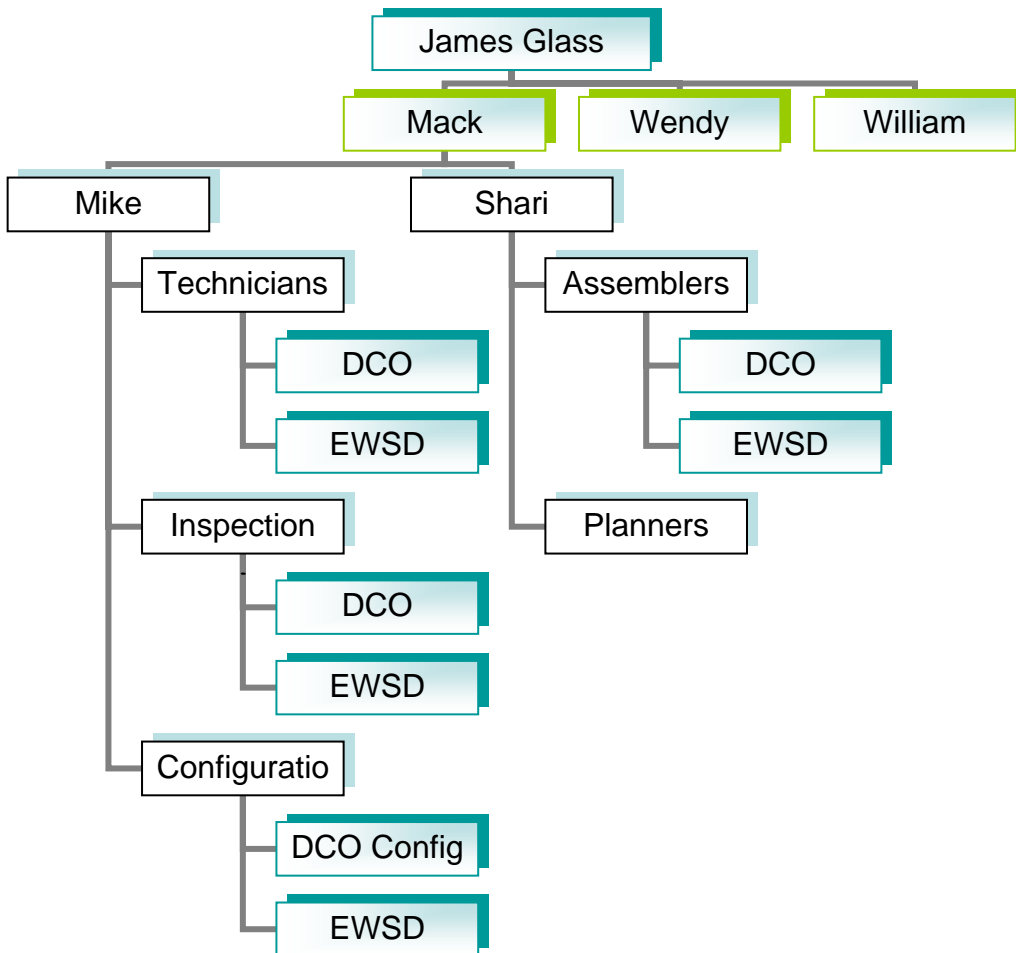
Since Systems Test had been running on it's own during the year that Wesley was setting up the Assembly teams, Glass and Kiefer decided not to put a manager over that Department but instead the team leaders would report directly to the new director Wendy Kiefer. Ms. Kiefer placed Shari Lastarza as manager of the Assembly Department mostly because she had run that



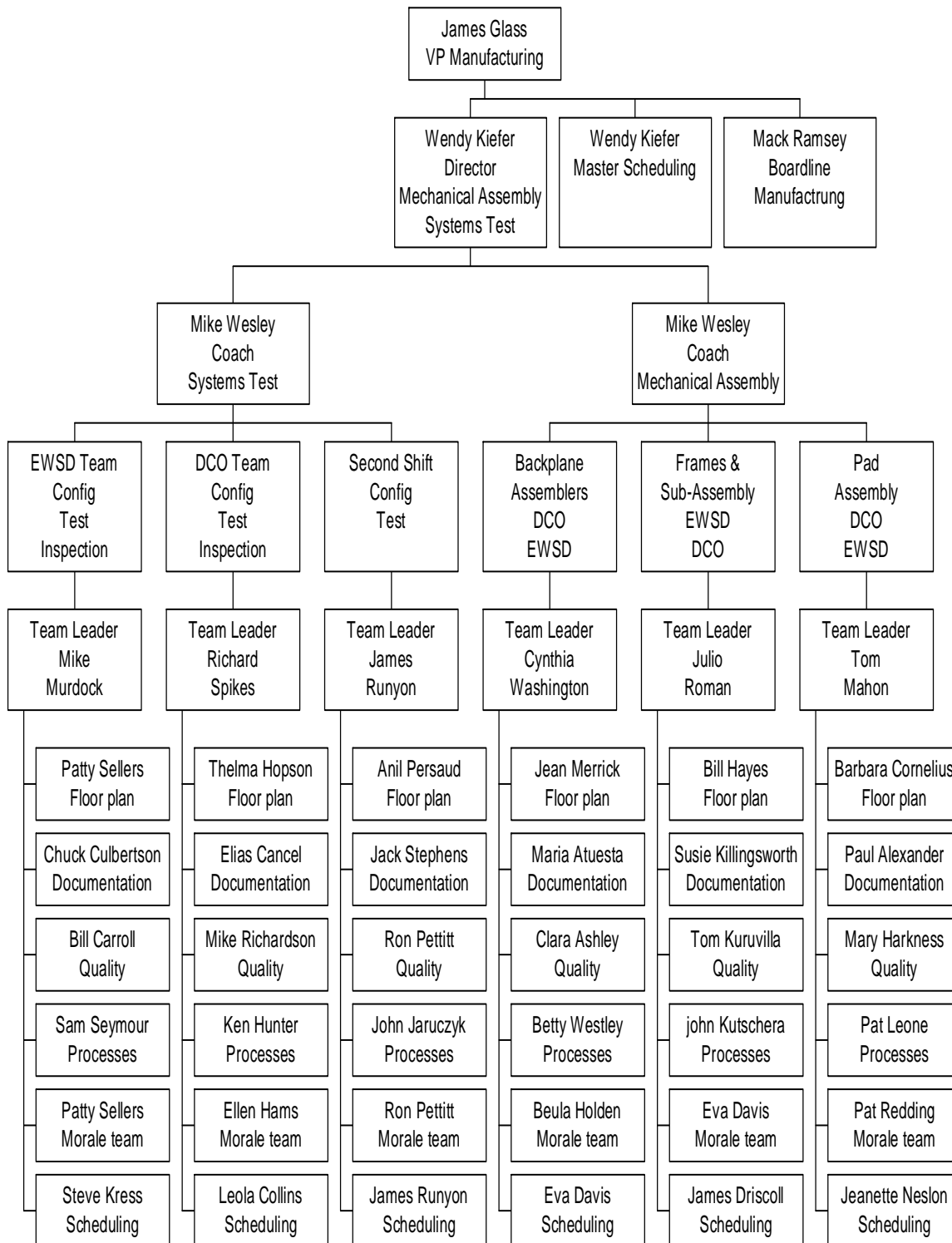
department in the past and this was considered a smooth transition and would not interrupt production flow.

Although Wendy Kiefer was very pro empowerment and team environment, Shari Lastarza was not and felt that there was a lack of control in the Assembly Department. Shari openly stated that “There can only be one manager, and with teams there is too much confusion.”

### Appendix A Manufacturing 1997



Appendix B  
Manufacturing 2000



## **TEACHING NOTE**

### **Disassembling the Team at Vanguard Electronics**

#### **INTRODUCTION**

The strategic management literature states that firms who wish to have a competitive advantage through high customer service (rapid response) and product differentiation need to restructure their organization into empowered, self-managed work units so as to ensure that there is “value-added” at each stage of the value chain. (Porter, 1985; Hill and Jones, 2001) In this case, Vanguard altered part of its structure through the development of teams in order to maximize its operations; and given their results Vanguard successfully put theory into practice.

And why shouldn't they? Much of the management literature in the last two decades has focused upon team building, cross-functional work teams, and self-managed work teams. Teams have been elevated in status to be the working unit of choice, the best method in which to have expertise placed closest to the customer. Man, being both gregarious and specialized in nature, works far better in a team environment where he can meld his skills in a synergistic fashion. Group think aside (Janis, 1971), team management, whether in the form of committees, product/project groups, or think tanks, seems to be a very effective method for structuring work and organizations, particularly for firms whose competitive strategy is differentiation.

So what is the problem? When the major supporter of team management, Mike Wesley, leaves the firm, he is replaced by Wendy Kiefer, a strong supporter of team structures. Her replacement, Shari Lasterza, however is the “old” assembly manager and does not buy into the team concept. Could this be anything but a formula for disaster?

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

This case was written for several different and distinct audiences: undergraduates taking an introductory management and organizational behavior course; students in advanced management course including team management. or organizational change and development.

In terms of the management and/or organizational behavior course, the case should be introduced after the students have read chapters on team management, organizational structure, and organizational change (Ex., Robbins and DeCenzo, 2004, Chapters 9, 5, and 7; Nelson and Quick, 2003, Chapters 9, 15, 18). The case functions as an excellent bridging mechanism between the individual and group levels of organizational analysis and demonstrates the connectivity of subsystems within the organization (see Kotter, 1978). One suggestion is that this case be used right after the section on organizational structure (Robbins, 2003) in order to not only reinforce the group issues raised in the case but to begin the discussion with students on group and subsystems issues as they relate to individual behavior and change management. For other, more complex management courses like organization development, group dynamics, or organizational theory, the case should be introduced after a discussion of job design and team building with particular attention paid to the structure of informal groups. (Fujishin, 2001)

Second, the case also has value for students taking an introductory course in organizational change and development in that it addresses issues relating to both team formation and building. This case could be utilized by instructors after the chapter on creating a team (Herrenkohl, 2004, Chapter 1) team interventions (French and Bell, 1999, Chapter 9) or managing change (Cummings and Worley, 2001, Chapter 10).

### **Learning Objectives**

The overall purpose of this case is to introduce students to change management, team building,

and internal change agents. Students obtain a “real-world” feel for the overall business setting, and, in particular, the individual and group forces that shape the team work environment. This is of particular value to students since many of them may have or will enter the work force and deal with similar problems and situations posed in this case. Students are asked to probe beyond personalities and the immediacy of the moment and examine the systemic aspects of the presented problem.

Specific learning objectives are as follows:

1. For students to analyze the change methodology in creating teams at Vanguard through Kurt Lewin’s (1951) concepts of unfreezing, moving, and refreezing.
2. For students to understand the role of Mike Wesley in that change (internal change agent).
3. For students to develop recommendations regarding the new team leader of the assembly team, Shari Lastarza.

## **TEACHING STRATEGIES**

### **Preparing the Student Prior to Case Analysis**

There are several approaches, none of which are mutually exclusive, that an instructor may employ in terms of utilizing this case. It is strongly recommended that regardless of the specific methodology employed, that students prior to reading this case be exposed to some material on team building (Dyer, 1977), organizational design (Nadler and Tushman, 1988), and change management (Mourier and Smith, 2001).

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

- a short lecture and/or discussion session on the above noted topics.
- a reading assignment prior to reading the case that covers several of the topics mentioned.

- a short student presentation on each topic.
- a guest lecturer on one of the topics.

### **Traditional Case Method**

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

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

### **SUGGESTED QUESTIONS AND ANSWERS**

The following questions may be employed by the instructor either as guidelines for the instructor for case analysis and/or as questions to be distributed to the class in conjunction with the case. This methodology provides the instructor some latitude in terms of how much direction he or she wishes to provide the student and, therein, allows the instructor to modify the difficulty of the case to fit his or her class's needs. The theoretical foundations for answers to these questions may be found in the following sections (after the epilog) which summarize the related literature.

**1. Analyze and describe the change methodology used in creating the first teams at Vanguard through Kurt Lewin's (1951) concepts of unfreezing, moving, and refreezing model. What steps were or were not taken and why?**

Kurt Lewin noted that change occurred in three stages: unfreezing (preparing the organization and its members for change and overcoming resistance to change), moving (intervening in the organization's normal processes and instituting changes), and refreezing (solidifying the change and making sure that the change has actually occurred).

Individuals are likely to resist change for three reasons: a) change replaces the known with ambiguity and uncertainty. Many employees resist learning something new because they fear that they will be unable to do so. b) Change threatens the investment people have made in the status quo. They fear losing something they already have. Employees become tied to the money, status, authority and other benefits that they have become familiar with over time. This why, in general, older employees are more resistant to change than younger ones. c) People believe that change is incompatible with the goals and best interest of the organization, that it may result in lower productivity or quality. Substantiating change to these individuals may be beneficial in proving its validity and/or identifying snags. (Mainiero and Tromley, 1994.)

Techniques for overcoming resistance (unfreezing) include: a) Communicating with employees to help them see the logic of change through one-on-one discussions, memos, group meetings and reports. The downside to this approach is it's time consuming and assumes that miscommunication was the source of resistance. b) Having affected employees participate in the change process can foster commitment and increase the quality of the change decision. However, the disadvantages are that this is time consuming and may result in a poor solution. c) Providing employee counseling and training to help them acquire new skills can ease the fears associated with change. However, these processes can be time consuming and expensive. d) When resistance comes from a powerful source such as a union or senior executives, then negotiation (exchange something of value for a reduction in resistance) may be required. However, the change agent managing the negotiation may later be blackmailed by others in power or used as a scapegoat; reason for the change not working. e) Manipulation (the covert attempt to influence by distorting facts), cooptation (a combination of participation and manipulation) or coercion (issuing threats) are inexpensive tactics for overcoming resistance. (Power, Gannon, McGinnis, and Schweiger, 1986)

The idea of going to a team environment with empowered employees came about as a way to combat the growing morale problems faced as a result of the downsizing process that most of the manufacturing field had been implementing to cut costs.

**Unfreezing** - None of the participants, including management, had experience with teams nor did they have any training when the new structure began. Empowerment and interpersonal relationship skills training was conducted by Human Resources instructors with each department member receiving a book on empowerment and asked to read it and provide feedback. At first there was reluctance on the part of the technicians, some of them felt they



had enough work to do already and didn't want any added responsibility without added compensation. The classes helped to show the employees how the team environment worked and that the added responsibility was a benefit to them, not a hindrance.

**Moving** - The three teams were split by product type and shift coverage. These three teams each were headed by a team captain. Richard Spikes was team leader for the DCO team, Mike Murdock was team leader of the EWSD team and James Runyon was the team leader of the night shift team. At the outset, all personnel agreed with the choices of team leaders and the team format provided. Once the teams were set up and training was given, the process of working as a team was started. Mr. Wesley gave out assignments for each team member so that each member was also a member of a "sub" or lower level team. The daily responsibilities for running the department were given to the team members.

An important sub-team was the Morale Team. Wesley felt that morale was at an all time low, and it was this feeling that was one of the driving forces behind going to the team concept in the first place. Noticing that not all of the technicians were as excited as he was for this new process, he decided if he had a team of "cheerleaders" promoting the team concept process and at the same time asking for opinions and suggestions for improvement, it could help to get everyone on board. That was the Morale Team's function.

Mr. Wesley worked with each team member to assure that they were properly trained on the processes and that they were on the right track before letting them on their own in the decision-making process. All team members had the opportunity to rotate responsibilities after some time had passed so they would be able to try their hand at the different aspects of the manufacturing processes. These moves were agreed upon by the members and the team found it helped members to find their comfort zone within the teams. Each team was responsible for the

following: Scheduling, Quality, Floor Plan, Training, Maintenance and Calibration, Team Leader, Documentation, Morale and Process Improvement.

**Refreezing** - The newsletter (The Peoples' Paper), which was conceived of and designed completely by the Morale Team of Systems Test, was published monthly and explained in the Team's words what each team responsibility entailed as well as progress reports from the teams. The newsletter also contained articles and fun facts about manufacturing. The first month introduced the Morale Team and told what they were about and what they wanted to accomplish. Subsequent issues featured the quality team and introduced all the team leaders. Each issue also had a section called the "Coaches' Corner" where the Morale Team would interview upper management on an aspect of the team concept or manufacturing processes and put their views in writing. Each person that was interviewed for the paper was asked "what they thought about the team concept?" After 2 years the teams were functioning rather smoothly and taking on most of the responsibilities of the department.

All of the steps in the change process seemed to have occurred in the development of the original teams.

**2. Were there any critical differences between team formation in the test department versus the assembly department. What made those differences critical?**

There were several critical differences: a) Mr. Wesley got together with the Test Department and also asked for their help in building up the teams in the Assembly Department. He created the structure for the teams in Assembly and asked that the test personnel work with the assemblers to get them going. So the schedulers from Test worked with the schedulers from Assembly, the quality people from each department worked together, and so on. This facilitated the change process since Mr. Wesley and the Test workers had developed both experience and expertise in

creating and implementing teams as well as the fact that Test employees mentored Assembly employees through the change process.

b) Wesley was told in confidence that some management felt that the team concept would not work in the Mechanical Assembly Department because there were so many processes in building the different systems, the department was too large, and most importantly, the employees didn't have the education required to handle all of the aspects of empowerment. When Wesley spoke to the employees within the department they had mixed reactions to the team concept. Half were excited because they had seen what it had done for Systems Test and wanted to experience some of the freedoms that went along with the team environment. Others didn't want the added responsibilities and felt they didn't have enough time to commit, and there were some who felt it wouldn't work because they wouldn't be able to get everyone to carry the work load evenly. The negativism and resistance to change demonstrated by the Assembly team seemed greater than the test team but since it was expected, the creation of teams occurred.

c) Wesley was told by Jeannette Nelson, that the people in Mechanical Assembly felt that it was just a "Wesley project" and when he was replaced, in a year or so, the teams would stop when a new manager came in, so "why bother working harder on a team." The Mechanical Assembly Department had 7 different "bosses" in the last few years. Again, this seemed to indicate a greater resistance to change than the test group and the fact that support for teams needed visible top management support.

d) Formal training was not provided the Mechanical Assembly Department. This is critical not only in the fact that the Assembly teamed lacked the knowledge and experiences of their counterparts in testing but also in that it sent a negative message to the Assembly team in terms

of management's support of team building. This created an inequitable situation between the two work groups and may have heightened the Assembly teams' expectations of failure.

**3. Describe Mike Wesley's role of in the change process for the Mechanical Assembly Department. Could he have benefited from an external change agent?**

Many organizations realize that very few of their in-house personnel have the expertise and the credibility to effectively serve as change agents. External change agents, OD consultants, serve a very useful purpose in that they provide a world view, serve as sounding boards and counselors, provide conceptual stimulation, new ideas and images, tend to be charismatic, and usually energize the change process.

Organizations that use external change agents have the task of educating the change agent as to the organizational processes, functions, and interdependencies (single loop learning) -- it is through this education that the external change agent starts the diagnostic process. The fear is that the external consultant will get sucked into organizational politics and in the long run lose objectivity.

Usually coming from personnel offices, training departments, or management service departments (although they may be an assistant or an assistant to a major officer of the organization), internal change agents bring with them a wealth of knowledge about the organization and the biases attached to being members of the organization. Internal consultants bring a tactical eye to the organization in that they garner information about organizational coalitions and serve as an intelligence gathering mechanism for top management. Secondly, internals can cultivate new ideas and new attitudes by disseminating the proper information to

the correct parties. They also serve as trainers by developing and running management training and development programs.

Many organization members, unfortunately, usually see internal consultants as tainted commodities. Internal change agents may be the most honest and sincere people, yet they all have organizational bosses they report to. Those involved with the intervention usually assume that the change agent's boss will eventually learn all and, therefore, will keep these change agents at arm's length.

Numerous authors in the field have noted that the most successful method for inducing change has been to develop a change agent team consisting of both internal and external change agents. This combination allows for the objectivity and expertise required for the development of employee trust in terms of data analysis and confidentiality as well as lays the groundwork for institutionalizing change by having in-house personnel learn change methodology. Furthermore, the internal change agents provide not only a linkage to the organization for the external agents, they also serve as the first teachers of those agents in terms of the processes and culture of the organization. (Rowley and Sherman, 2001)

Mike Wesley clearly was an internal change agent in the team formation process for the Mechanical Assembly Department. He developed the change plan, worked with his new employees in the assembly department to create the teams, brought in support for the new teams from his other employees in Testing, and provided support material to the Assembly Department when none was forthcoming from human resources and top management. Interesting enough he did encounter resistance from the Assembly Department because he was an insider but managed to overcome that resistance and produce positive results.

In terms of requiring an external change agent, perhaps this individual would have provided

greater expertise and also sent a message from management that this was not just Wesley's project. Clearly, this outside agent could have worked with top management in preparing them for the changes that were to occur (i.e. other departments wanting empowerment, the development of an in-house newspaper) and the refreezing of the assembly team post Wesley. More specifically, the consultant could have assisting in the selection and training of the new assembly supervisor and ensure that the team approach would have been more inculcated into the Assembly department's culture.

**4. Given the comments of the new team leader of the assembly team, Shari Lastarza, develop recommendations that would solidify the team approach for the assembly department.**

Shari openly stated that "There can only be one manager, and with teams there is too much confusion" and felt that there was a lack of control in the Assembly Department. Since, as part of the assembly department, she had not attended the training sessions that the testing department underwent, it is clear that she may either not understand the purpose and functions of teams and/or does not subscribe to empowering employees (has an autocratic style of leadership).

Shari needs to understand that team-based structures break the organization down into work teams that perform all of the basic functions of the organization within their organizational unit. The strengths of these groups lie in their ability to immediately react to the demands of the marketplace without having to refer key organizational decisions up a hierarchical chain. By allowing those closest to the problem to make critical decisions, the organization takes advantage of employee skills and expertise in a quick and reliable fashion. The downside to this structure is

the greater need for information processing systems that allow for intra and inter-team planning and communications. (Housel, 2002)

Students may suggest that if Shari does not subscribe to employee empowerment that she be replaced by a supervisor who supports the team concept and will nurture employee development.

**5. Given how the case ends, what is your prediction for the future use of teams the Vanguard? What do you think happened to the Assembly team?**

This is an open-ended question and allows the student to speculate as to the firm's future actions and allows for good discussion and debate in class. The case notes that James Mack, VP for Manufacturing, and Wendy Kiefert, the who supervised Wesley and is now supervising Shari Lasterza, strongly support the team concept. The case also notes that other departments within Vanguard wish to employ the team concept and that the team approach has lead to increase productivity, greater operating efficiencies, and higher morale. Given all of this good news, students might project the increase use of teams at Vanguard.

However, students may also note that Shari is not a supporter of the team concept and therefore the Assembly team and may be altered by Shari to work using the old organizational structure. See Case Epilogue below.

**Case Epilogue**

The structure for the teams in Assembly was left but Shari ran the Department and all decisions concerning scheduling and processes. The budget for fiscal 2002 was reduced because of a loss of profits in 2001 and a decrease in sales forecast for 2002. After upper management went through the team training, all other training classes were put on hold and talks of starting teams in Manufacturing were placed on the "back burner" until the Company made it through the bad

economic times. With all this news and the change in management, the people of the Assembly Department stopped having meetings and dissolved the teams in October of 2001 (See Appendix TN-A, Manufacturing 2001). Systems Test was still running as teams and continued to look for ways to reduce production costs and increase efficiency.

## AN OVERVIEW TO TEAM MANAGEMENT

The next Section provides an overview to team management and may serve as a class handout.

### Types of Teams

**Work teams** are formal groups, composed of interdependent individuals, responsible for the attainment of a goal. Teams may be formed to carry out a specific purpose (reengineering or product development), may be temporary (task force, problem solving) or permanent (sales), functional or cross-functional, and supervised or self-managed. **Functional teams** are composed of a manager and direct subordinates from a functional area. They are often involved in efforts to improve work activities or to solve specific problems within their domains. (Housel, 2002)

Increasing in organization popularity are **self-directed** or **self-managed teams**. They operate without a manager and are responsible for a complete work process or segment that delivers a product or service to an external or internal customer. **Cross-functional teams** have also gained popularity. Individuals from various specialties work together on various tasks. (Weiss, 2001)

### Growth in Popularity of Teams

There are numerous reasons to employ a team approach, they include:

*Creates Esprit de Corps.* Team members expect and demand a lot from each other. Their norms facilitate cooperation and improve employee morale.



*Allow Management to Think Strategically.* Self-managed teams liberate manager's time to focus on strategic issues.

*Speeds Decisions.* Members are closer to and more knowledgeable of work related problems.

Empowering teams to make their own decisions creates greater flexibility for faster decisions.

*Leverages Work Force Diversity.* Teams composed of members with different backgrounds and experience tend to make more innovative and better decisions than individuals.

*Increases Performance.* Combining the above factors results in teams more efficiently and effectively than do individual focused organization designs. (Power, Gannon, McGinnis and Schweiger, 1986)

### **Characteristics of Effective Teams**

Groups become teams when goal achievement requires interdependence, and all members are held accountable to each other for results. Teams are effective when members share a clear understanding of the goal, the belief that it embodies a worthwhile result, and a personal commitment to its achievement. They have the technical abilities to achieve desired goals and the personal characteristics to achieve excellence and harmony when working with others.

Teams are also effective when members of high performance team have integrity and character as well as competence. This combination facilitates the development of mutual trust. This is a fragile and important ingredient. Organization culture and managerial practice can facilitate the building of trust. Trust also nurtures the development of member loyalty and dedication to the team. This unified commitment translates into the willingness to expend extraordinary amounts of energy to achieve goals.

High performance teams have open and effective communication and feedback processes. This includes nonverbal as well as verbal messages. Members can quickly and effectively share ideas and feelings. Members confront and reconcile differences, demonstrating flexibility and maturity in negotiation skills.

Effective leaders in high performing teams are coaches and facilitators who help guide, support and bring out the best in members. In conjunction with the organization, they help ensure that the infrastructure is sound by providing necessary training when needed and recognition when earned. (Gido and Clements, 1999)

### **Managing Effective Teams**

According to the basic functions of management: planning, organizing, leading and controlling, high performance teams require:

Planning. Effective teams have clear, accepted goals. Management needs to ensure that members understand what it is they are to achieve.

Organizing. Management must clarify how much authority a team actually has. Self-managed teams are empowered to make decisions. Other forms of teams may have different authority boundaries. Structurally, leaders need to be selected, roles identified and work processes created.

Leading. The leader's role, communication process and conflict management techniques require definition early in a teams creation. Leaders need both technical knowledge and interpersonal skill to motivate outstanding performance, resolve conflict and gain consensus around key issues.

Controlling. How will team performance be evaluated and how will they be rewarded?

Performance criteria clearly need to be reflective of the team context. Group incentive plans, such as gain sharing, rewards teams for succeeding. The teams themselves should participate in deciding how appraisals and rewards will be determined.

Teams have become central to new organization structures and designs. Whether engaged in TQM or quality circles, organizations are increasingly relying the expertise and character of its human assets to create and sustain competitive advantage. Clearly, when employees with diverse backgrounds, experiences and knowledge bases are brought together to solve problems they are close to or to innovate new processes, the firm benefits from creative and committed activity to ensure its perpetuation.

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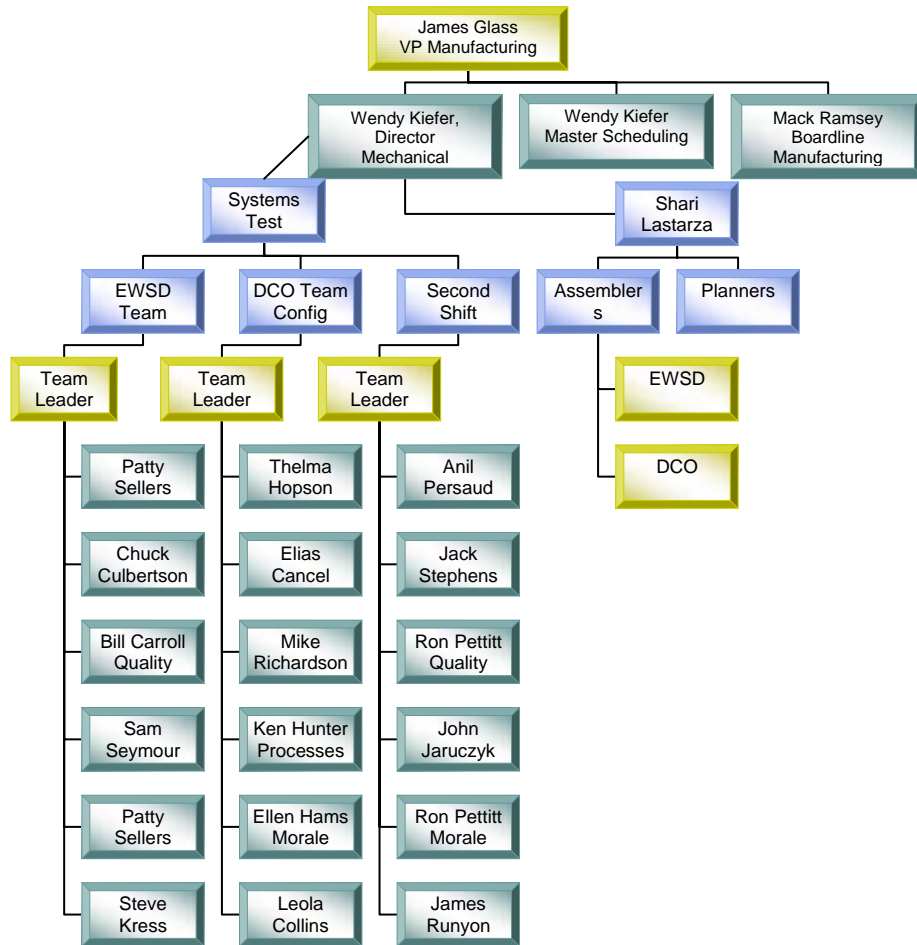
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Appendix TN-A  
Manufacturing 2001



## Hunting for Bambi

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*Presented at the REGULAR session of the Case Association 2004 Meeting*

Keywords: business ethics, gender issues

### ABSTRACT

This case is based on a series of articles published from July 10, 2003 through August 28, 2003 by KLAS-TV in Las Vegas, Nevada. The main character is interested in earning money to pay bills, and is presented with an opportunity to take a job as "prey" for hunters with paint guns. Among the questions that students are asked: what does this incident "say" about society?

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### Scenario A: Hunting for Bambi

Robin, 25, is a secretary for a nonprofit organization in Las Vegas. She earns about \$25,000 a year – a pretty good salary, except her salary does not begin to cover all her bills. It's expensive to live in Las Vegas. She was discussing her increasing debt, yesterday, with her friend, Paul. Paul had a way she could earn extra money.

“I know it's hard to make ends meet, Robin.” He looks around Robin's apartment. It is a one bedroom apartment in a poor section of town. The walls are cracked, and the air conditioning unit in the wall is working hard to keep the main room cool.

“Yeah, Paul. It is. But I wouldn't mind if I could make ends meet. Right now, I can't see the ends. If I don't get a raise soon, I'm going to have to file bankruptcy and leave town...and I don't want to do that.”

Paul looks thoughtful. Then he says, “Look, I have a friend. Tom Trumbull. Tom's okay. He has this deal where he has to hire women for this game he runs. The game is called “Hunting for Bambi.” Shall I go on?”

Robin, interested, nods yes.

Paul says, “You get paid between \$1000 and \$2500 for this work. You run around outside for a couple of hours, and it’s fun.”

“Wow, between \$1000 and \$2500 for a few hours of work? That’s unbelievable. What’s the catch?” asks Robin.

“Well,” says Paul, “you are Bambi...and these guys pay to hunt you with a paint gun.”

“Paul, I’m desperate. Can you put me in contact with this guy, Tom?” Paul agrees. Later that day he calls Robin to tell her he has set up a meeting with Tom for the next day at 6pm. He and Tom will come to her apartment, after Robin gets off work to discuss the job.

The next day, Robin has just gotten home from work when her door bell rings. Looking through the spy hole, she sees Paul and another man waiting to be let in.

“Hi, come on in.” Both men enter her apartment and are seated. Paul begins.

“Well, Tom. This is Robin. I told you she expressed some interest in the job opening you have, and I thought you two should meet and see if things work out.”

“Cool,” says Tom. “Robin, would you mind standing up and turning around for a moment?” Robin looks confused, but complies with Tom’s request. He looks her over, and motions for her to be seated. “Let me explain a few things, Robin. In my business, the women I hire have to look attractive – which you are. Your looks are one of the things that my customers are interested in. The other thing, my customers are interested in is hunting. You would be the quarry. Do you have a problem with this?” Tom looks at Robin.

“No, I don’t have a problem,” says Robin. “But there’s got to be some kind of catch, right? I mean, you just don’t pay up to \$2500 to a woman to run around while some guy tried to shoot her with a paint gun, right?”

Paul and Tom look at each other. Then Tom says, "that's right. There is a catch. You would be naked – except for running shoes."

Robin hesitates. Naked and being shot at by a man?

"My customers come to hunt a naked woman. The adventure is taped and the hunter gets to take his video home with him. My customers are only allowed to use paint guns, and are not suppose to shoot their quarry above the chest. Sometimes, though, a few of the hunters get carried away. The main goal is to be as true to nature as possible. I don't go deer hunting and see a deer with a football helmet on so I don't want to see one on my girl either. Shall I go on?"

Robin is thinking hard. She looks over at the pile of bills on her dining room table. She needs to do something here. "Yeah, go ahead. Tell me more."

Tom looks relieved. He continues. "The paint balls that come out of the guns travel at about 200 miles per hour. Getting hit with one stings when you're wearing clothes. Without clothes, the pellets are powerful enough to draw blood. But, every woman I have hired, has been able to overlook that because of the money. If you don't get hit by a paint pellet, you earn \$2500. If you do get hit by a paint pellet, you earn \$1000."

Robin leans forward in her chair. "How often would you need me?"

Tom and Paul exchange a glance. The worst part is over. Tom answers, "I could use you every weekend day if you're game. You're cute. You're smart. This is good, clean fun. What do you say?"

**Call for action:** If you were Robin, what would you say to Tom? If you were Robin, what should you say to Tom? If these responses are different, why are they different?



## **Scenario B: Hunting for Thumper**

[This is the same scenario as Hunting for Bambi. Just copy the scenario above and change the names of the characters. Robin should become Rob. Paul should become Paula. Tom Trumbull should become Angel Trumbull.]

Rob, 25, is an administrative assistant for a nonprofit organization in Las Vegas. He earns about \$25,000 a year – a pretty good salary, except his salary does not begin to cover all his bills. It’s expensive to live in Las Vegas. He was discussing her increasing debt, yesterday, with his friend, Paula. Paula had a way he could earn extra money.

“I know it’s hard to make ends meet, Rob.” She looks around Rob’s apartment. It is a one bedroom apartment in a poor section of town. The walls are cracked, and the air conditioning unit in the wall is working hard to keep the main room cool.

“Yeah, Paula. It is. But I wouldn’t mind if I could make ends meet. Right now, I can’t see the ends. If I don’t get a raise soon, I’m going to have to file bankruptcy and leave town...and I don’t want to do that.”

Paula looks thoughtful. Then she says, “Look, I have a friend. Angel Trumbull. Angel’s okay. She has this deal where she has to hire men for this game she runs. The game is called “Hunting for Thumper.” Shall I go on?”

Rob, interested, nods yes.

Paula says, “You get paid between \$1000 and \$2500 for this work. You run around outside for a couple of hours, and it’s fun.”

“Wow, between \$1000 and \$2500 for a few hours of work? That’s unbelievable. What’s the catch?” asks Rob.

“Well,” says Paula, “you are Thumper...and these women pay to hunt you with a paint gun.”

“Paula, I’m desperate. Can you put me in contact with Angel?” Paula agrees. Later that day she calls Rob to tell him she has set up a meeting with Angel for the next day at 6pm. She and Angel will come to his apartment, after Rob gets off work to discuss the job.

The next day, Rob has just gotten home from work when his door bell rings. Looking through the spy hole, he sees Paula and another woman waiting to be let in.

“Hi, come on in.” Both women enter his apartment and are seated. Paula begins.

“Well, Angel. This is Rob. I told you he expressed some interest in the job opening you have, and I thought you two should meet and see if things work out.”

“Cool,” says Angel. “Rob, would you mind standing up and turning around for a moment?” Rob looks confused, but complies with Angel’s request. She looks him over, and motions for him to be seated. “Let me explain a few things, Rob. In my business, the men I hire have to look attractive – which you are. Your looks are one of the things that my customers are interested in. The other thing, my customers are interested in is hunting. You would be the quarry. Do you have a problem with this?” Angel looks at Rob.

“No, I don’t have a problem,” says Rob. “But there’s got to be some kind of catch, right? I mean, you just don’t pay up to \$2500 to a man to run around while some woman tried to shoot him with a paint gun, right?”

Paula and Angel look at each other. Then Angel says,” that’s right. There is a catch. You would be naked – except for running shoes.”

Rob hesitates. Naked and being shot at by a woman?

“My customers come to hunt a naked man. The adventure is taped and the hunter gets to take her video home with her. My customers are only allowed to use paint guns, and are not suppose to shoot their quarry below the chest. Sometimes, though, a few of the hunters get carried away. The main goal is to be as true to nature as possible. I don’t go rabbit hunting and see a rabbit with a football helmet on so I don’t want to see one on my boy either. Shall I go on?”

Rob is thinking hard. He looks over at the pile of bills on his dining room table. He needs to do something here. “Yeah, go ahead. Tell me more.”

Angel looks relieved. She continues. “The paint balls that come out of the guns travel at about 200 miles per hour. Getting hit with one stings when you’re wearing clothes. Without clothes, the pellets are powerful enough to draw blood. But, every man I have hired, has been able to overlook that because of the money. If you don’t get hit by a paint pellet, you earn \$2500. If you do get hit by a paint pellet, you earn \$1000.”

Rob leans forward in his chair. “How often would you need me?”

Angel and Paula exchange a glance. The worst part is over. Angel answers, “I could use you every weekend day if you’re game. You’re cute. You’re smart. This is good, clean fun. What do you say?”

**Call for action:** If you were Rob what would you say to Angel? If you were Rob what should you say to Angel? If these responses are different, why are they different?

## **HUNTING FOR BAMBIE OR THUMPER**

### **TEACHING NOTES**

#### **Case Overview**

In both scenarios, male and female students are presented with a situation in which they have to decide if they want to be employed as “prey” for “hunters” with paint guns. The situations are the same, except for the gender of the main character (Rob/Robin), employment circumstances are unusual, and potentially hazardous.

This exercise is based on a series of articles published from July 10, 2003 through August 28, 2003 by KLAS-TV in Las Vegas, Nevada (Reuters, 2002; Sorrell, 2003(a), (b), (c); Unknown, 2003(a), (b)). While the facts the articles were based on have proven to be false since publication, the incident is not that far-fetched, and could actually manifest itself at some time in the future.

This exercise is appropriate for a business ethics, or women studies classes.

#### **Teaching Objectives**

The teaching objectives of this critical incident are:

1. to discuss the ethics of making certain decisions
2. to highlight differences in attitudes that may exist based on gender
3. to discuss how our decisions reflect our values.

#### **Questions**

- 1. What would you do if you were Rob/Robin?**
- 2. Is there a problem with this kind of sport?**
- 3. Should businesses be allowed to profit off human beings – for any reason?**
- 4. What does this incident “say” about society?**

Above are general discussion questions that the instructor can use to structure analysis of the situation. There are no wrong answers to these questions. Students should be strongly encouraged to justify their responses to the questions.

### **General Discussion**

Before you use this exercise, review the television “articles” for the complete story. This way you will be able to provide context for your students’ discussion.

You can use this exercise two ways. Give your male students the exercise titled, “Hunting for Thumper;” your female students should be given “Hunting for Bambi.” Have your students form groups of approximately four to five members. If possible make the groups a single gender. Advise each group to discuss the likelihood of their participating in this venture. Why would people want to do this or why not? If you were a friend of either Rob or Robin, what would you advise them to do?

After the groups have discussed the incident thoroughly, bring the class back together and address the questions in this teaching note.

The second way you can conduct this exercise is to have mixed groups read and discuss “Hunting for Bambi” (only). Again, have your students form mixed groups of approximately four to five members. Advise each group to discuss the likelihood of their participating in this venture. Why would people want to do this, or why not? If you were a friend of Robin, what would you advise her to do?

After the groups have discussed the incident thoroughly, bring the class back together and address the questions in this teaching note. Regardless of how you use the incident, be prepared for some anger.

## **Analysis**

### **Gender issues**

Nontraditional, female students in particular have expressed a lot of anger about this incident, worrying over the image of women this incident portrays, and the unfairness of the situation. Because non-traditional female students have had to work against the stereotypes of their families as they pursue their college careers, this incident lays bare some of the feelings some women have long repressed.

There is a history of research that examines the “threat of violence” to women (e.g. Belknap, 2001; Schechter, 1982). This research indicates that the message of the vulnerability of women is deeply and culturally embedded. The stories that mothers tell their daughters often revolve around restricting behavior, actions, and clothing to prevent something dreadful from happening. Moreover, women are rarely able to predict when a threatening or intimidating form of male behavior will escalate to violence (Belknap, 2001). The incident attached describes what could be perceived as a “threat” to women – even though the female employees are voluntarily placing themselves in these situations. Yet, literature notes that even this voluntary “threat” serves to define the place of females in culture – controls the place of females in culture (Schechter, 1982).

There is the very real possibility, in this incident, of violence occurring to Robin in the future, if she accepts employment. There is an element too, in this incident, that because Robin places herself in a threatening situation, she deserves what she gets. We all have preconceived notions of what kinds of people get victimized. Putting herself in this situation will mean, to some readers, that Robin is consenting to whatever arises between herself and any man who arranges to “hunt” her. The implication is that certain women are “fair game” to be sexually

victimized, and therefore they cannot be assessed as legitimate victims (Burt & Albin, 1981). By consenting to be the “prey” in this incident, Robin may be perceived as losing her right to determine what happens to her.

Past discussions of this incident bears out this warning. Having used the incident with same gender groups, male students were more apt to see the character Rob on a continuum: from non-sexual to athlete. Male students talked about the character Rob’s prowess at eluding his hunter, just as they joked about Rob’s vulnerability naked. Once the same gender groups were brought back together, the character Rob was not discussed again; instead, Robin became the focus of all conversation in the class. Males began to discuss the character Robin as a sexual character, a pornographic character, and not as a female with the right to safe employment. Often male students referred to the character Robin as more a prostitute than as just another employee. Female students essentially shut down during the conversation because they were uncomfortable with the turn the discussion was taking. These students felt victimized because there was no empathy for the character Robin; clearly the character deserved to be “hunted” and exploited, and the character chose to be victimized, rather than be treated with respect.

In an attempt to allow male students to feel the “threat”, in the past, the instructor has played “what if” with the students. What if Rob were hunted by a male? Would men perceive Rob to be threaten in the same way that women perceive Robin to be threatened? The answer is no. Male students were unable to feel the same kind of threat that female students felt. One of the reasons may be the cultural biases our students are socialized into.

In any case, the incident clearly delineates the gender disparities in power. Be aware of this in your classes.

## **Ethical issues**

Essentially, discussion, at some point, should revolve around the sanctity of human life, or from a Kantian perspective, a prior condition of duties to others is our duty to ourselves. As Immanuel Kant wrote in *Lectures on Ethics*, “Only if our worth as human beings is intact can we perform our other duties; for it is the foundation stone of all other duties. A man who has destroyed and cast away his personality, has no intrinsic worth, and can no longer perform any manner of duty (Falikowski, 2003).” What does this mean?

Well, this quote means that Kant is not a relativist. He would not accept the opinion that if Rob or Robin, as adults, wanted to take the job, that would be a good thing for them. Morality is not a matter of opinion or preferences. Morality is not completely dependent on culture, history or social factors. As Falikowski (1998) writes, [a]lthough it is undeniably true that people are different and often choose to differ with one another on moral matters, that fact alone does not, for [Kant], make everybody right and nobody wrong. It is also certainly true that cultural practices vary throughout the world and that different values are held in higher or lower esteem depending on the society, group or nation involved. Accepting these facts, moral certainty can not be found in human experiences, beliefs, feelings, and variable values. If morality is to make any sense, and be considered valid and binding for all, then moral certainty must be found in the structure of reason – independent of experiences. The moral judgment is not derived from experience in this instance, but from reason – independent of what people actually do. Our rationality or reasoning ability is shared worldwide by all peoples. Thus, reason is the faculty by which we can know universal moral principles.

Now some students will not want to accept the premises of the Kantian perspective, and that's okay. There is plenty of foundation for a discussion of the sanctity of human life. Most



religions base their arguments about the sanctity of human life on the idea that life is a gift of God in the formation of the created world. All life is precious, but God uniquely creates human life in His "image and likeness." Human life as such is deserving of deep respect and individual human beings are to be treated in accordance to their inherent human dignity (Harakas, 2003; Kasdan, 2003; Sweeney, 1999).

Other sources of this belief include American Law (Bush, 1992), medicine (donoharm.org, 2003), and education (Spanier, 1996). In some ways a belief in enhancing a certain quality of life also supports the contentions of the Kantian perspective. Based on the premise that life is good, that obtaining pleasure and reducing pain is a good thing, these beliefs about the quality of life, have as their most basic assumption, a value of life perspective. Even individualism posits a judgment about the value of life that can not be escaped. If I operate in a way to improve my life, then I must see my life as important. In addition, if I operate in a way so as to use other people to improve my life, then I must see these others as important to my situation's improvement; hence these others have a value to me. Perhaps, Kant and individualists have different degrees of value for human life, whether as an end in itself or as a means to an end, but both perspectives value human life (Veerhoven, 1999).

This being said, if human life has value, then business should be careful about the ways in which profit is made from human life. In a very real sense, the value of a human being can be understood in terms of the quantity of good the human can create. Failure to understand that will result in waste. These are basic economic principles (see O'Sullivan & Sheffrin, 2003).

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## **Malden Mills Industries, Inc.**

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### **ABSTRACT**

Malden Mills Industries, Inc. is a textile manufacturer best known for its famous “Polartec” brand fleece fabric. The company is known for bucking trends in the textile industry by staying in the high cost New England area and maintaining a set of employee-centered human resource policies. Intense competition in the textile industry and an economic recession has put the company into bankruptcy. The case opens as the company’s long-time CEO, Aaron Feuerstein, attempts to secure funding in order to buy the company back from creditors, maintain its independence, and continue being “employee-centered.”

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In the Fall of 2003, Aaron Feuerstein, Chairman and CEO of Malden Mills, Inc., sat gazing out his office window at the company’s headquarters in Lawrence, Massachusetts. As he contemplated the changing seasons and observed a few colorful, but dying leaves flutter to the ground, he wondered if this was a metaphor for his company’s fate. The sudden chill in the air seemed to reflect the new attitude of Malden Mills’ creditors. Life had taught Aaron Feuerstein that nothing remains the same forever. However, just as the sun was now beginning to set, Feuerstein, always the optimist, knew it would rise again, and bring a new day and renewed hope for Malden Mills to emerge from Chapter 11 bankruptcy.

Aaron Feuerstein achieved notoriety for his generosity to his employees after a tragic fire in 1995. The day after the fire, Feuerstein quickly vowed to rebuild Malden Mills, and made an unexpected announcement to pay all employees’ salaries and benefits during the reconstruction period. Several workers wept for joy as Feuerstein declared his commitment. Unfortunately, Mr. Feuerstein may have built too extensively, a gamble that left Malden Mills particularly vulnerable to a downturn in sales of its trademark Polartec fleece and forced it into bankruptcy in

late 2001.<sup>1</sup> Potentially, 1,200 good factory jobs held by residents of Massachusetts and New Hampshire might be lost if the company's creditors take control of the company and move production overseas. Feuerstein and his family had until August 26, 2003 to complete the financing of a plan to buy back Malden Mills for \$93 million and prevent this from occurring.<sup>2</sup> Unfortunately, Feuerstein failed to meet this deadline. Now, Feuerstein will have a year from the time it emerges from Chapter 11 to come up with \$120 million to \$125 million to buy the 90% of Malden Mills his family has always owned.<sup>3</sup> Feuerstein has already secured a \$20 million loan from the U.S. Export-Import Bank. Additional funding sources remain uncertain. However, a "white knight" appears to have recently emerged. As of October 1, 2003, Feuerstein had enlisted the help of a Boston real estate developer, Winn Management Co., which would purchase undeveloped parcels of land adjacent to the Malden complex for \$100 million and build mixed-income rental housing on the property. In addition, it would also make an unspecified contribution to Feuerstein for his buyback.<sup>3</sup>

According to David Orlofsky, a consultant brought in to manage Malden Mills' operations during the bankruptcy proceeding, "if Aaron Feuerstein was John Doe, this buyback wouldn't be happening".<sup>1</sup> Orlofsky says that he has been involved with nine other bankrupt companies and seen few other equity owners remain in place. "I've never seen anyone get this far," the consultant said.<sup>1</sup> Aaron Feuerstein and the 1,200 employees at Malden Mills have to realize that they are faced with an uphill battle and they only thing they can do is have faith and take things one step at a time.

## COMPANY HISTORY

In the 1890's, Aaron's grandfather, Henry Feuerstein, emigrated to America from Hungary and located in New York City where he found a job sewing blouses. After losing his job twice, Henry turned to selling dry goods across the state. Henry prospered and soon established wholesale outlets. Unfortunately, Henry's real estate investments went sour and he lost a significant amount of his wealth. Henry responded by investing the remaining \$50,000 of his fortune on a small mill in Malden, Massachusetts.<sup>4</sup>

In 1906, Henry Feuerstein founded Malden Mills, which was originally called Malden Knitting, in Malden, Massachusetts. Malden Knitting produced wool "workman's" sweaters and bathing suits. In 1923, under the leadership of Henry Feuerstein, Malden Knitting flourished and created Malden Spinning and Dyeing, to meet the demand for military uniforms during World Wars I and II.<sup>4</sup> Towards the end of World War II, Malden Knitting experimented with a variety of fabrics and applications, in order to broaden the company's production capacity and to anticipate the changing needs of American families. During this time, Henry Feuerstein's son, Samuel, had taken charge of Malden Knitting and his teenage grandson, Aaron, was also working during school vacations in the family business. Upon graduating from Yeshiva University in 1947, Aaron was appointed factory supervisor. This was the only the beginning for Aaron Feuerstein, as he was on his way to a long and distinguished career at Malden Mills.<sup>4</sup>

In 1956, the company was renamed and relocated to Lawrence, Massachusetts. Malden Mills also achieved what the textile industry refers to as "vertical" continuous production with the dyeing, printing, and finishing processes all completed within one facility. In 1962, Malden Mills opened a new knitting mill in Bridgton, Maine, and four years later began producing synthetic fibers for the upholstery market. As Samuel Feuerstein was approaching retirement,

Aaron's role became increasingly visible. Under his guidance, Malden Mills became more automated and stayed in Massachusetts rather than following in the footsteps of other textile manufacturers by relocating to the South or the West Coast where land and labor were cheaper.<sup>4</sup> By the end of the 1960's, Aaron Feuerstein took full control of Malden and invested heavily on fake fur products by pouring \$20 million into specialized equipment, and opening mills in Hudson, New Hampshire, and Barre, Vermont. Even though the fake fur market experienced significant growth, Aaron realized that this segment was not as attractive as he originally believed.

In 1979, Malden Mills invented Polarfleece and forever changed the way the world dresses for cold weather. Polarfleece became the fabric of choice for high-performance athletic apparel because it had the capability of drawing moisture away from one's body while providing warmth. One of the first customers of Polarfleece was Patagonia, which produced outerwear for hikers, mountain climbers, and other outdoorsmen. Patagonia was extremely impressed with Polarfleece, and used this fabric for a variety of garments. Malden Mills' capitalized on the popularity of Polarfleece by producing several new lines of high-performance, technically advanced fabrics to serve numerous clothing manufacturers. In 1991, Polarfleece products were trademarked as Polartec Climate Control Fabrics available in light, medium, and heavyweight thickness with more than 100 different styles, ranging from underwear, bike shorts, and sweatshirts to jackets, wet suits, and gloves, which were all available in 5,000 colors and 1,000 patterns.<sup>4</sup> In 1999, Time Magazine named Polartec one of the top inventions in the past 100 years.<sup>5</sup>

On the evening of December 11, 1995, a devastating fire put Malden Mills' close-knit employee-based company to the test. An explosion generated a fire that swept through three of

the company's nine buildings, and injured 33 night shift employees. Approximately, \$500 million in damages was incurred. In addition, more than 1,400 people were out of work, 75% of the total Malden Mills work force.<sup>6</sup> In an era of downsizing, mergers, relocations, and closings, most doubted the site of the old mill would ever be revived. Many people doubted that Aaron Feuerstein, at age 71, would desire to rebuild rather than retire, relocate or even close down. Although many people may view the devastating fire as losing a major asset, Aaron Feuerstein, president and owner of Malden Mills and grandson of the founder, knew that he had incurred an expense, but did not lose his main asset; his employees. Before the ashes even cooled, Aaron Feuerstein announced that the mill would be rebuilt in a state-of-the-art, environmentally friendly facility in the same location. In a display of commitment to the community and employees, Mr. Feuerstein continued to compensate his staff during the rebuilding process by paying all his employees their regular salaries for 30 days and continued health benefits for the 90 days that followed the fire.<sup>4</sup> As a result, Aaron Feuerstein received international media attention, was interviewed on network television, and was even invited to attend the President's State-of-the-Union Address! Mr. Feuerstein sums it all up, somewhat in disbelief, "Everything I did after the fire was in keeping with the ethical standards I've tried to maintain my entire life, so it's surprising we've gotten so much attention. Whether I deserve it or not, I guess I became a symbol of what the average worker would like corporate America to be in a time when the American dream has been pretty badly injured".<sup>6</sup>

## **CORPORATE GOVERNANCE**

In an era perhaps characterized by corporate malfeasance, Aaron Feuerstein stands out as a model of social responsibility and corporate governance. Historically, Malden Mills has been a



closely held, private corporation. Its board of directors include Aaron Feuerstein, President and CEO, David Orlofsky, CFO and Frank Budetti, COO, as well as four other members.<sup>7</sup> The real force behind the company's governance system are Aaron Feuerstein's values which shape the Board's policies. These values are perhaps reflected in the following quote,

in corporate America, there is a terrible stress on maximizing shareholder profit in the short run. As a result, CEO's are taught to forget their ethical values so they can make short-term gains. They resort to terrible things...like cheating and falsifying numbers. It's a disgrace, and then they get bailed out. We have a mission of responsibility to both shareholders and our top asset: our employees. We're not prepared to skip town for cost savings. It's not about each quarter.<sup>8</sup>

Asked about CEO pay, Mr. Feuerstein recently responded,

CEO pay has been abnormally high because of the obsession with short-term share price. Executives should be figuring out how to get their company secure over the long term. And for that you can't afford to pay yourself these outrageous sums. CEOs have forsaken their responsibility to both employees and shareholders. You make a false show of high profits and then take the money and run.<sup>8</sup>

## **THE TEXTILE INDUSTRY**

### **General**

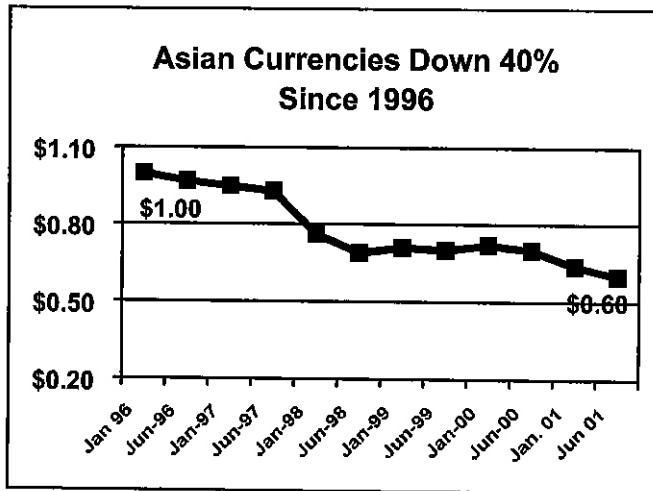
According to the U.S. Census Bureau, in 1997, 452 establishments were engaged in the production of manmade fiber and/or silk broadwoven fabrics in the United States. More than 85 percent of the industry's total employment of 77,129 was directly involved with the production of these broadwoven fabrics. Total payroll was more than \$2.0 billion, and the value of shipments exceeded \$10.6 billion.<sup>9</sup> The principal fibers that are used in broadwoven manmade fiber fabrics for apparel are polyester, rayon, and nylon with occasional use of polypropylene or olefin fiber. These fibers are generally used for a variety of outerwear, leisure and activewear, coats, suits, sleepwear, and lingerie.<sup>9</sup> Producers of broadwoven fabrics of manmade fiber and silk are for the most part vertically integrated textile manufacturing companies; that is, most

broadwoven companies manufacture their own yarn requirements, as well as, dye and finish their own fabrics.

Producers of broadwoven fabrics of manmade fiber and silk face two types of competition for market share, especially in the apparel sector. First, the increasing consumer preference for products made from natural fibers has emerged as a competitive threat.<sup>9</sup> Products made from natural fibers, including cotton and wool, are a viable substitute for those made from synthetic fibers. Cotton Incorporated, an organization that is sponsored and paid for by the cotton growers of the United States, was formed in 1971 in an attempt to offset the huge gains in market share being made by polyester. This organization's primary purpose is to promote the use of cotton in fabrics, and since its founding, cotton has increased its U.S. market share at the expense of manmade fiber in production of broadwoven fabrics every year.<sup>9</sup>

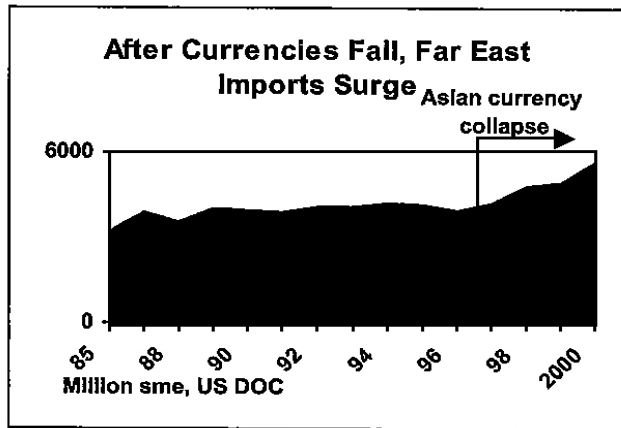
The second type of competition comes from fabrics and garments imported from developing countries. From 1997 through 1998, overall imports of fabrics from Asia increased 35 percent. During that same period, manmade fiber fabric imports from Asia increased by 51 percent. In 1998, overall textile imports from Asia increased to 6.6 billion square meter equivalents (sme). Three of the countries showing large gains in textile imports to the United States were Thailand, at an increase of 37 percent; Pakistan, at 36 percent; and Japan, at 30 percent. Conversely, U.S. exports to these following regions fell 30 percent, 35 percent, and 25 percent, respectively. In addition, total U.S. exports to the region were down 24 percent to \$853 million.<sup>9</sup> This surge in foreign imports and the corresponding decline in exports was, in part, driven by an economic recession in Asia that led to an approximately 40% decline in the value of Asian currencies (Exhibit 1). As a result, textiles imports from Asia surged as they became significantly less expensive than those produced in the U.S. (Exhibit 2)

Exhibit 1  
Asian Currency Devaluation



Source: The American Textile Manufacturers Institute

Exhibit 2  
Asian Textile Imports



Source: The American Textile Manufacturers Institute

The textile industry in the United States, once a global powerhouse, has been devastated by foreign competition. Exhibit 3 documents the extent of textile plant closings during the period 1997 through 2003. Decades ago, many textile mills relocated to the American south

from the industrial northeast to take advantage of cheaper land, and lower labor costs and taxes. Companies from New England, where labor costs were especially high and environmental regulations particularly strict were greatly affected. However, as Exhibit 3 illustrates, even companies located in the south began to be greatly impacted by textile manufacturers from developing economies where costs are even lower.

Exhibit 3  
Textile Plant Closings (as of November 5, 2003)

	2003	2002	2001	2000	1999	1998	1997
United States	42	42	116	29	35	26	14
North Carolina	23	20	31	14	16	9	6
South Carolina	9	5	31	6	5	4	6
Georgia	1	1	16	2	4	6	0
Virginia	1	3	4	1	3	2	1
Alabama	3	1	7	0	0	0	1
All other states	5	12	22	6	7	5	0

Source:  
The  
American  
Textile  
Manufacturers  
Institute:  
“Textile

Plant Closings”.

Malden Mills was one of the few textile manufacturers to buck this trend and survive the 1990’s by remaining in New England, maintaining their workforce, and caring for the environment. For example, Malden Mills demonstrated their commitment both to the community and to the environment by building a water treatment plant to restore the Spicket River system, which was impacted by the company’s mills. The treatment plant conserved energy and reduced waste, air emissions, and the amount of chemicals necessary to produce its

many fabrics. In 1994, Malden Mills once again illustrated their commitment to the environment by hiring the former leader of the state's Fish and Wildlife Commission to lead their continuing environmental efforts. The company further reduced consumption and added reuse and recycling programs. In 1994, Malden Mills was recognized by the American Textile Manufacturers Institute (ATMI) for environmental "excellence" and leadership in the textile industry.<sup>4</sup>

In October 1998, textile mills witnessed the introduction of a new electronic database, which is designed as information gathering center between the U.S. textile industry and its suppliers. The Voluntary Product Environmental Profile (VPEP) is an effort to make the exchange of important information that relates to the environment, health, and safety in a more efficient manner. Not only does VPEP make the exchange of data more efficient between manufacturers and their suppliers, but it also presents information that is required for regulatory compliance and assists them in making better environmental decisions in relation to their operations. Technology, particularly automation and the use of the Internet have become increasingly pertinent to the textile industry. Textile mills have used computerization to develop quick response programs (QR) that shorten the time between the placement of retail orders and the delivery of textile goods to stores. Communicating through the use of bar codes and electronics data interchange has enabled companies to use information to direct production. Reductions in inventory costs have benefited textile mills along with apparel manufacturers and retailers.<sup>9</sup> In 1999, textile companies were turning their efforts to deliver the right designs at the right time, which was accomplished by purchasing new and expanded Computer Aided Design (CAD) equipment. CAD equipment was able to work up to ten times faster than old systems. Digital printing systems, which include a wide-format printer capable of printing rolls of fabric

up to 60 inches wide, and specially formulated inks and software, were used by manufacturers to reduce costs and speed delivery.<sup>9</sup>

Towards the end of 1999, the Internet was introduced to the textile industry as an additional opportunity for product distribution. The Internet technologies allowed buyers to search a large database of fabrics and to place orders online. The database contained digital images of samples sent by the manufacturers along with detailed product specifications. The Internet allows manufacturers of broadwoven manmade and silk fabrics to reach a larger, worldwide market of prospective buyers.<sup>9</sup>

### **Major Competitors**

Malden Mills' major domestic competitors are Cone Mills, Burlington Industries, and W.L. Gore & Associates, Inc. Cone Mills is not only the world's number one maker of denim, but also the largest commission printer of home-furnishings fabrics in North America. Levi Strauss & Co., its largest customer (nearly 35% of sales), makes its 501 jeans solely from Cone Mills' proprietary fabric. Other denim customers include The Gap and VF Corporation. The company also makes jacquard fabrics and offers commission finishing, including custom printing and dyeing services, to the home decorative, specialty apparel, and craft fabrics markets. In addition, Cone Mills has a joint venture in Mexico to produce denims.<sup>7</sup>

Burlington Industries is considered a fabricator for the fashion industry. Although currently in Chapter 11 bankruptcy protection, the firm is one of the largest U.S. fabric makers. The company makes wool worsted and worsted-blend fabrics, denim, cotton and cotton-blend fabrics, and waterproof synthetics for the apparel market. Burlington's interior furnishing fabrics

unit makes woven jacquard mattress ticking and jacquard used in office, hospitality, and health care goods.<sup>7</sup>

W.L. Gore & Associates makes a variety of fluoropolymer products, which are best known for its breathable, waterproof, and windproof GORE-TEX fabric. Product uses range from clothing and shoes to guitar strings, dental floss, space suits, and sutures. In addition to its apparel (popular among hikers and hunters), W.L. Gore makes insulated wire and cables, filtration products, and sealants. Fabrics are offered under such brands as AIRADVANTAGE, DRYLOFT, and WINDSTOPPER.<sup>7</sup>

## **MARKETS AND PRODUCTS**

Malden Mills holds a trademark on its primary branded product, Polartec. However, the product was never patented. This means that although the “Polartec” brand name is proprietary, potential rivals are free to manufacture and distribute synthetic fleece fabrics with similar characteristics and properties. This has subjected the company to fierce competition from foreign rivals with more favorable cost structures. The company has responded to this threat of imitation through an aggressive differentiation strategy.

This strategy has two components. First, the company has cultivated and maintained relations with upscale, quality-oriented purveyors of outdoor equipment and apparel. Polartec maintained its position as industry leader because of its stretch, fast wicking, easy dyeing, and durable, non-pilling finish. Customers such as Eddie Bauer, Land’s End, L.L. Bean, Ralph Lauren, and others often base their entire outdoor or athletic lines on Polartec fabrics.<sup>4</sup> Land’s End, Inc., a major user of Polartec fabric, was purchased in entirety by Sears Roebuck, and Co. in July of 2002. Sears has begun to sell Land’s End products, including those using Polartec

fabric. Malden Mills regards its new access to Sears' retail network of 870 full-line stores as a significant growth opportunity.<sup>10</sup>

Second, the company has divided the market for Polartec products into distinct segments. It has targeted each segment by customizing the fabric to meet the specific needs of each customer group, and through product innovation and enhancement. Polartec has tailored to the needs of people who enjoy winter sports by providing an ideal layering system for skiing, snowboarding, ice-climbing, snow-shoeing, and ice fishing, etc. Polartec's mantra remains that one's layering system is only as good as the base layer. Simple management of Polartec's layering system can ensure comfort in winter conditions from 40 below to 40 above, due to *Polartec Power Dry* or *Polartec Power Stretch* for moisture management, including a mid-layer of *Polartec Thermal Pro* for added warmth and top with weather protection including *Polartec Power Shield* or *Polartec Windbloc*.<sup>5</sup>

For people who enjoy working out in comfort and in style, Polartec Polar Dry is the foundation of Polartec's fitness collection for any activities such as, yoga, working out, running, rowing, racquet sports, or walking. *Polartec Power Dry* is the most efficient wicking material on the market to keep one feeling dry whatever one's level of exertion maybe. *Polartec Power Dry* is also available in everything from smooth silkweights to versions with silver X-Static fibers that naturally suppress odor. As for *Polartec WindPro*, it is very breathable, wind resistant fabric for cooler weather activities, such as walking or hiking. In addition, *Polartec Power Stretch* provides additional 'compression stretch' support and wicking, which is popular for yoga, cycling, running, and dancewear.<sup>5</sup> Because the company lacked the necessary equipment and expertise to produce technical stretch fabrics, it entered into a partnership with United Knitting, a specialized fabric mill. Under the terms of this agreement, United will produce technical stretch



fabric under the Polartec name exclusively for Malden Mills. Malden Mills will be able to enter this new market without having to make an additional investment in capacity.<sup>10</sup>

Outdoorsmen, such as hunters and fishermen, may face certain conditions that require the most advanced fabrics and clothing. *Polartec Power Dry* with X-Static fibers not only keeps one comfortable and dry, it too offers sun protection and effectively manages odor. *Polartec Thermal Pro* is warm, lightweight, and dries quickly. *Polartec Wind Pro*, which is Polartec's new 'super-fleece' is not only wind resistant, but is also a very quiet material that is ideal for moving unnoticed. In addition, for much colder and rather harsh conditions, *Polartec Power Shield* is the most versatile, durable outerwear that Polartec has ever made.<sup>5</sup>

Certain professions, such as, fire fighters, law enforcement, construction, utility and industrial workers, require people to work in harsh conditions. The company has labeled this the "work wear" market and estimates it to be \$2.75 billion in size. Polartec is attempting to provide these workers with fabrics that have excellent value, are durable, and perform well. Specialized garments made of Polartec fibers have been created to conform to employee's working conditions. *Polartec Thermal-FR* with NOMEX fibers offers flame resistance and static management. *Polartec Classics* are stand-by insulation favorites that last virtually forever, provide unrestricted movement, and are machine washable, soft and comfortable. Also, *Polartec Wind Pro* provides the added benefit of wind resistance without sacrificing breathability. Not only will employees be proud to wear Polartec because of its performance, but also because it was produced by a labor-friendly company like Malden Mills.

The U.S. military has also emerged as a strategic market for the company. Polartec has helped keep the U.S. Military the best equipped in the world. The company has worked closely with all branches of the military to develop a variety of remarkably innovative Polartec fabrics.

As a result, Polartec gear has been used to a large extent in Afghanistan during 2003 and has performed quite admirably under the harshest of combat conditions. The U.S. Military has awarded a 97% approval rating in field testing to clothing items manufactured out of Polartec fabrics, which has the highest rating ever recorded for a piece of issued gear.<sup>5</sup> Polartec is now identified by brand name in military garments.<sup>10</sup>

Technological innovation also helps the company meet the demands of its customers. Some technological breakthroughs that Polartec has created are Polartec Heat Technology, Polartec Thermal-FR, and Polartec Power Stretch-RX. Polar Heat Technology. Polartec Heat Technology provides warmth on demand during stop-and-go activities. Polar Heat panels deliver three modes of user-adjustable warmth, due to power provided by rechargeable lithium ion batteries. Providing warmth only when needed reduces the need to add or subtract layers of clothing as weather or activity levels change.<sup>5</sup> Three main components that help make Polartec Heat Technology to provide warmth are thermal panels, controller, and lithium ion batteries, and thermal mannequin testing. Thermal panels are very thin, lightweight, flexible, durable, machine washable, and are designed not to interfere with a garment's function. The panels are activated by the user and with a controller, which can be demonstrated by the following example: when resting after a period of high exertion, the user turns the panels on. When resuming activity, the user turns them off, as the body's increased activity level provides the necessary warmth to maintain core temperature.<sup>5</sup> The Polartec Heat Controller, has a tethered design, which provides for easy temperature adjustments by the user. This component features three modes; full power, oscillate or power off. A quick squeeze of the side button turns the system on, providing warmth on demand; and another squeeze turns the system off. A large center button selects between full power and oscillate. Due to the easy to use controller, power is on only when needed, and as a

result, battery life is optimized.<sup>5</sup> The lightweight lithium ion batteries that provide power, have been custom designed with rounded corners and a durable outer case. The batteries may be recharged without removing them from the garment, using standard 110-volt household current, an available solar powered charger, or adapted to a vehicle's 12-volt cigarette lighter port. Battery life is 5 hours on oscillate, and 2.5 hours on full power.

Polartec Heat panels deliver three modes of user adjustable warmth. This active heating breakthrough reduces the need to add or subtract layers of clothing as weather or activity levels change. When set on low, Polartec Heat Technology provides thermal insulation equivalent to adding an additional layer of Polartec 100 Series fleece. When set on high, Polartec Heat Technology is equivalent to adding an additional layer of Polartec 300 series fleece.<sup>5</sup> Such "electronic textiles" provides "virtual layering" that allows the outdoor enthusiast to quickly add and subtract insulation at the touch of a button. Polartec Heat Technology therefore reduces the need to put on or take off additional garments, allowing users to travel more rapidly and with less weight.<sup>5</sup>

Another technological breakthrough is Polartec Thermal-FR with NOMEX, which is the reference standard for flame resistance, lightweight warmth, and breathability. Since Polartec Thermal-FR is made with NOMEX, it will not melt or drip. These durable fabrics are also non-pilling and maintain their insulating ability after repeated laundering. Thermal-FR with NOMEX keeps one safe, warm, and comfortable in a wide range of conditions.<sup>5</sup>

Another technological breakthrough is the Polartec Power Stretch-RX, which features body-hugging four-way stretch and excellent breathability. Polartec Power Stretch-RX features a unique three-dimensional spacer construction that provides multi-directional stretch and recovery for strong support, compression, and padding. The soft, brushed next-to-skin surface

has moisture management properties that allow the skin to stay dry and comfortable. The fabric is constructed with knit-in-perforations to provide enhanced breathability and a technical aesthetic.<sup>5</sup> Polartec Power Stretch-RX is useful for active pursuits where superior comfort, breathability, freedom of movement, and cushioning or padding are desired.<sup>5</sup>

Malden Mills, maintains the value of the Polartec brand through strategic use of advertising. The company wants its advertising to do more than simply inform athletes and adventurers –it wants to inspire them. Backbone Media’s strong background in the world of print advertising has helped the company in this regard. Backbone Media has a thorough understanding of a media outlet’s position in the marketplace, true paid circulation, rate structure, negotiation opportunities, and overall value. As a result, Backbone has assessed and recommended publications for a range of companies including not only Polartec, but also Patagonia and Cloudveil.<sup>11</sup> With the help of Backbone Media, Malden Mills’ campaigns continue to reinforce their position as the world’s leader in performance fabrics by running ads in international outdoor and specialty magazines. As a result of successful advertising, Malden Mills has over six hundred brand partners in more than fifty countries who use Polartec fabrics in their garments. Among them are many of the most respected apparel brands in the world, such as, Columbia Sportswear, L.L. Bean, Lands End, Polo RLX, Reebok, and Timberland, which is in both North American and Europe.<sup>5</sup> This advertising has therefore helped the company maintain valuable relationships with many of the textile industries leading brand names.

## **INTERNATIONAL OPERATIONS**

Expanding sales volume in Europe led to the establishment of Gorlitz Fleece GmbH, a German company, 94% effectively owned by Malden Mills. This company was established to

serve the European market and to avoid high freight and duties imposed by the U.S. government. Gorlitz runs a 250,000 square foot state-of-the-art manufacturing plant employing approximately 300 workers. The Gorlitz operation enables Malden Mills to fill its European orders at a significantly lower cost than if the fleece were internally sourced from its Massachusetts plant or outsourced from a third- party, European vendor.<sup>10</sup>

The company has also been considering a move to expand its Asian operations. At one time, the company was the dominant supplier of synthetic fleece to the Asian market. New industry entrants and a continuing recession in Japan have reduced Pacific Rim sales from 3.2 to 1.0 million yards in 2002. In order to reverse this downward trend and recapture the strategically significant Asian market, the company has partnered with Shanghai Challenge Textiles, an Asian manufacturer of fleece and jersey knits. Shanghai Challenge will dedicate 100% of its fleece production capacity to Polartec. Shanghai Challenge also has what is called a “cut and sew” operation. Malden Mills will establish an office in Hong Kong for customer sales and service, as well as to monitor quality and provide technical expertise to Shanghai Challenge. Court filings state, “[t]his strategy will provide certain of the [company’s] customers with the synergies of having the entire garment produced in a low cost region.”<sup>10</sup>

## **THE PEOPLE**

Because Polartec is not patented, Malden Mills has to rely on the dedication, commitment, and inventiveness of its people to continuously create and produce a stream of high quality innovative products such as those described above. The company therefore regards its people as a strategic resource, and has not hesitated to invest in, support, and maintain its workforce. Approximately 1200 people are employed at the company’s Lawrence/Methuen

facility, which is one of the 10 largest employers in northwestern Massachusetts. The company's hourly employees are represented by the United Needletrades, Industrial, and Textile Employees Union ("UNITE"). The company has never suffered a strike or a threatened work stoppage.<sup>10</sup> In addition, the company's response to the tragic fire is further testament to its values and policies regarding its people.

Just minutes after the fire started, Bill Perez and the HR director at the time, Alan P. Kraunelis, heard about the fire and rushed to the HR offices, which were not located in the buildings that were on fire, and retrieved the personnel files. Retrieving the personnel files were the first things that came to their minds because they wanted to contact the families of injured employees. "Quick instincts. Unwavering conscience. Risk and faith. That's what Perez and Kraunelis demonstrated that night – traits only to be further exemplified by the CEO Aaron Feuerstein and the Lawrence community immediately thereafter".<sup>12</sup>

According to Kathy Skala, current HR director, the spirit of family resonates as a corporate value in this family-owned company. The fire was not only felt by the Feuerstein family, but by the 3,000 employees and surrounding community. HR shifted into high gear, by working closely with a Crisis Team, composed of Feuerstein, the COO, CFO, HR and representatives from each department. According to Perez, the team met daily to discuss the status of those injured, to assess the immediate needs of Malden employees, to set up a communications and workers' training center, to call upon community resources, and even to collect Christmas presents for the children of Malden's corporate family.

Since most of the mill was destroyed, a series of operational moves were made to keep production going. Dyeing and printing were outsourced to other textile companies in Massachusetts and the South. Equipment designated for the company's German operations in

Goerlitz, was brought to the States. Even though this was a necessary move, it was unfortunate that 1,400 employees were temporarily displaced. However, instead of just laying off their employees, HR adapted to the changing events and reached out to the people of Lawrence for help. Longtime Malden employees, Kathy Skala, Alan P. Kraunelis, and Bill Perez, had more than 50 years of cumulative experience and extensive community ties. Kraunelis and Perez were able to locate a vacant mall and negotiated space for a workers' center that would become a place for employees to be updated on the company's rebuilding efforts, pick up their unemployment checks, and most importantly, to receive job training.<sup>12</sup>

According to Skala, because the local Chamber of Commerce joined in, Malden Mills was able to collect \$320,000 for an employee assistance fund, which then issued food vouchers to employees. In addition to the promise of federal and state dollars pouring in for training of dislocated workers, HR generated a plan to address such needs. HR was able to provide training that included English as a second language, GED's, and basic computer literacy. Rather than remaining idle, HR was able to provide employees with productive activities during reconstruction. While workers waited for the new state-of-the-art mill to be completed in September 1996, they were also able to learn the computer skills that would be required to run the new machines. In less than a year, more than 600 employees completed courses at the communications center or at outside training facilities. Malden's center had even received praise from the former Secretary of Labor, Robert Reich, as being a national role model for employee training and development. What began as a traumatic event ultimately rallied not only the company and community, but also others throughout the world. HR also received calls from out-of-state employers offering jobs to Malden's displaced workers, Malden Mills' employees enjoyed a reputation as a skilled and committed workforce brought numerous job offers. Of the

1,400 displaced employees, more than 90 percent of them have returned to work due to HR's dedication and commitment.<sup>12</sup>

Even though the fire was a tragic event, it taught the company a number of valuable lessons. These include: be active in the community and maintain relationships, participate in the Chamber of Commerce, know the leaders in local cities and towns, have a crisis plan in place and know who's in charge, know from whom you can seek help and have creativity in the management group.<sup>12</sup> Finally, due to HR's achievements, Malden Mills received the Workforce Magazine Optimas Award for Managing Change. As the HR department accepted the award with great pride, Feuerstein illustrated his respect for HR by sharing that "the tremendous amount of change in the past few years makes me once again recognize HR's strength and courage. At Malden Mills, we have the self-confidence to change without fear".<sup>12</sup>

## **IS DOING THE RIGHT THING THE RIGHT THING TO DO?**

Aaron Feuerstein has been a role model for American business people. Many people hope that he will succeed in raising the money to buy back his family's company. Close friends say that Feuerstein can't bear to lose the firm his grandfather founded in 1906. Financial projections obtained from the recent bankruptcy court filing indicate that the company anticipates that it will become profitable within the next two years if it continues to pursue its planned strategy (see Exhibits 4 & 5). If Malden Mills emerges from bankruptcy, Feuerstein will officially lose the title of chief executive, (though he will remain chairman of the seven-member board of directors, continue to receive his annual salary of \$475,000, and will own 5 percent of the company). Though he remains sharp-witted, even some of his allies worry about his pace and, should he succeed, they question whether he will again try to operate Malden Mills as a



closely held business. David J. Ferrari, a close friend, feels that Feuerstein “is not capable of running Malden Mills on a day to day basis, not at his age. Malden Mills has grown from a small to a major company, and I think Aaron’s way of running a company is to be everything to everybody”.<sup>13</sup>

Although his integrity is above reproach, the company’s creditors have raised serious questions with respect to Feuerstein’s strategic judgment. Did the \$400 million investment to rebuild the Lawrence plant after the fire leave the company especially vulnerable to economic downturns in the dog-eat-dog, global textile industry? Should the company have rebuilt at all in New England where taxes and labor costs are high and environmental regulation is strict? Or, should the company have relocated to a region where costs are lower? Is remaining an independent, family-owned business viable, or should the family consider selling out to a larger rival? Are its policies towards employees and the environment out of touch with contemporary reality? Is Malden Mills Industries, Inc. a quaint anachronism from a bygone era in this new age of cutthroat, global competition?

Exhibit 4  
Malden Mills Industries, Inc.  
Summary Projected Consolidated Income Statement (\$000's)

	FY Ended 2003	FY Ended 2004	FY Ended 2005
<i>Net Sales</i>	\$183,127	\$187,185	\$192,678
<i>COGS</i>	<u>95,231</u>	<u>99,250</u>	<u>102,452</u>
<i>Contribution</i>	<u>87,896</u>	<u>87,935</u>	<u>90,226</u>
Fixed Overhead	37,222	35,893	34,858
Product Dev.	3,784	3,830	3,545
Distribution	4,346	4,216	4,153
<i>Gross Profit</i>	<u>42,544</u>	<u>43,996</u>	<u>47,670</u>
Direct Selling	5,452	5,290	5,842
S, G&A	13,215	13,126	13,227
Corp. G&A	<u>17,061</u>	<u>17,060</u>	<u>16,026</u>
<i>Operating Income:</i>	<u>6,816</u>	<u>8,520</u>	<u>12,575</u>
Interest Expense	12,968	10,278	9,887
Other Expense	--	--	--
Income Tax	<u>1,166</u>	<u>1,419</u>	<u>1,769</u>
Earnings/Loss	\$ <u>(7,318)</u>	\$ <u>(3,177)</u>	\$ <u>919</u>

*Source:* United States Bankruptcy Court District of Massachusetts Western Division  
(Adapted)

Exhibit 5  
Malden Mills Industries, Inc.  
Summary Projected Consolidated Balance Sheet (\$000's)

	FY Ended 2003	FY Ended 2004	FY Ended 2005
<b>ASSETS</b>			
Total Current Assets	\$66,987	\$75,649	\$89,361
Net PPE	138,516	97,316	71,663
Other Assets	<u>15,381</u>	<u>15,260</u>	<u>7,262</u>
<b>Total Assets</b>	<b><u>\$220,884</u></b>	<b><u>\$188,225</u></b>	<b><u>\$168,286</u></b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>			
<b>Liabilities</b>			
Total Current Liabilities	\$22,263	\$23,050	\$27,758
Total Long Term Debt	160,925	130,661	105,096
<b>Total Liabilities</b>	<b><u>183,188</u></b>	<b><u>153,711</u></b>	<b><u>132,854</u></b>
<b>Stockholders' Equity</b>			
Capital Stock	19	19	19
Preferred Stock	-	-	-
Retained Earnings	37,677	34,495	35,413
<b>Total Stockholder's Equity</b>	<b><u>37,696</u></b>	<b><u>34,514</u></b>	<b><u>35,432</u></b>
<b>Total Liabilities and Stockholder's Equity</b>	<b><u>\$220,884</u></b>	<b><u>\$188,225</u></b>	<b><u>\$168,286</u></b>

Source: United States Bankruptcy Court District of Massachusetts Western Division  
(Adapted)

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**“MALDEN MILLS INDUSTRIES, INC.”**  
*(Teaching Note)*

**CASE ABSTRACT**

Malden Mills Industries, Inc. is a textile manufacturer headquartered in Lawrence, Massachusetts best known for its famous “Polartec” brand performance fleece fabric. Traditionally, the company had been a closely held, family-owned business led by its long-time Chairman and CEO Aaron Feuerstein. The company is also known for bucking trends in the textile industry by staying in the high cost New England area and maintaining a set of human resource policies which can perhaps best be described as employee-centered. For example, after a devastating fire that effectively shut the company’s U.S. operations down, Feuerstein received international media attention and won acclaim for continuing to pay his employees their salaries and benefits while the plant was rebuilt into a \$400 million state-of-the-art manufacturing facility. Unfortunately however, intense competition in the textile industry and an economic recession has put the company into bankruptcy. Creditors have taken possession and forced Feuerstein to step down as CEO. The case opens as Feuerstein attempts to secure funding in order to buy the company back from creditors, maintain its independence, and continue being “employee-centered.” Competitive forces in the global textile industry, the company’s strategic responses, as well as Feuerstein’s ethos are highlighted.

**TEACHING OBJECTIVES**

This case is designed to meet a variety of objectives. First, the case illustrates a company that truly follows the “stakeholder” as opposed to the “stockholder” approach to fulfilling its

mission, as well as in the formulation and implementation of its strategy. That is, many of the company's strategic decisions are based on the best interests of its employees and the community of which it is a part, rather than those of the providers of financial capital. Second, the case illustrates the role of values and ethics in the governance of the firm. The company's long-time Chairman, Aaron Feuerstein has some very clear beliefs about the role of top management and governance that differ markedly from those which seem to be found in much of corporate America. Third, the case illustrates the tension between long- and short- term approaches to management. Malden Mills Industries, Inc. does business in the global textile industry. Case facts illustrate the generally "unattractive" characteristics of this industry such as competition from low wage, developing economies and generally homogeneous products that are easily imitated. Although it would be relatively easy to adopt a short-term approach such as outsourcing production to geographic regions where wage rates are lower, or attempting to achieve concessions from its workforce, Malden Mills appears to have taken a longer-term approach by remaining in its community, investing in a state-of-the-art facility, and investing in its workforce. The benefits and costs of this approach can be discussed. Finally, the case can be used to discuss the competitive strategy of attempting to build capabilities that are unique relative to rivals. Malden Mills policy of investing in its work force and staying in high cost New England is significantly different from the model typically followed in the global textile industry. The goal of the strategy seems to be to promote creativity and innovation on the part of its people in order to differentiate its products from the competition. Therefore, the case also illustrates the strategic use of its workforce, or "strategic human resource management."

## **COURSES, LEVELS, AND TOPICS**

This case can be used in a variety of contexts. Perhaps its primary use would be in an integrative, capstone strategic management course. However, the case can also be used to illustrate the stakeholder approach, as well as ethics and values in a social issues course. Additionally, the case can be used as an integrative case for a lower level introduction to management course. Finally, given the company's employee-centric approach, it would also be useful in human resource management courses. Topics covered include:

- industry analysis
- competition
- social responsibility and ethics
- decision horizons
- bankruptcy
- corporate governance
- strategy formulation
- strategy implementation
- generic competitive strategy
- human resource management
- escalation of commitment
- crisis management.

## **QUESTIONS FOR DISCUSSION**

1) What are the most significant threats and opportunities in the global textile industry?

This question sets the stage for understanding the pressures confronting the company. The textile industry appears to be very prone to competitive entry by foreign firms that may have more favorable cost structures due to lower wage rates, taxes, and levels of environmental regulation. Textiles also tend to be

somewhat homogenous and commodity-like. Also, there are potentially a great many substitutes for different fabrics. This is particularly the case for synthetic fibers that must compete with natural fibers such as cotton and wool. The industry is also very cyclical.

2) Comment on Aaron Feuerstein's decision to remain in New England and invest \$400 millions in a new, modernized facility? Was this a good idea given your answer to 1) above, or does it represent an "escalation of commitment to a failing course of action?"

This question really gets to the heart of the matter. Given competitive forces in the global textile industry, one point of view might suggest that Feuerstein's decision was driven by his emotional attachment to his family's firm and the textile industry. Thus, it represents a misallocation of capital and illustrates an, "escalation of commitment to a failing course of action?" On the other hand, hindsight is 20/20. This decision can also be viewed as very courageous and entrepreneurial. Such a long-term decision should perhaps not be judged in the short-term. Temporary adversities such as economic recession can obscure the true long-term potential of this decision. Given an economic turnaround and the right owners willing to be more patient (e.g., Winn Management) the company might have the potential to succeed.

3) What do you think about Feuerstein's decision to continue to pay wages and benefits during the rebuilding of the Lawrence facility? Was there a political dimension to this decision?

Again, this illustrates the tension between long- and short- term management. The case can be made that this was a long-term decision that benefited both employees and the community. However, there is a competing perspective. The case can be made that this decision was actually short-term. Although paying employees during the reconstruction period assuaged the initial problems brought about by the plant fire, the cost incurred may have contributed to the present financial situation and jeopardized the long-term viability of the company.

This decision, however, when viewed from a more political perspective, was also quite cagey. Feuerstein's decision made him the darling of politicians seeking reelection, organized labor, and the press. This effectively constrained creditors to be a bit more patient when the company subsequently ran into financial trouble. Forcing such a responsible and compassionate organization into bankruptcy might be viewed negatively by the general public. Creditors, such as large financial institutions might be well advised to take this into consideration when dealing with this bankrupt.



4) What are the company's strategic alternatives?

This is a very open ended question. First, students will have to choose the manner in which the company will emerge from bankruptcy. Options may include:

- accepting Winn Management's offer
- attempting to locate another friendly funding source
- allow creditors to shop the company to potentially larger rivals
- close the Lawrence facility and relocate overseas
- liquidate the company.

Additionally, students can choose to emphasize one or more of the company's products and market segments.

5) Which of Porter's generic competitive strategies is the company following? How viable is this strategy?

This is a classic strategic management question. The company appears to be pursuing a strategy of differentiation, possibly with a focus orientation. The company seems to be attempting to differentiate itself through innovation and focus on certain specific market segments. Also, the company's treatment of its employees can be viewed as a way of implementing this strategy in addition to being the ethical thing to do. The case can be made that more committed, secure employees will be likely to invent and produce more innovative products. As usual however, there are competing perspectives. After all, how many variations of polyester fleece can the market absorb? Malden Mills may be too dependent on one product. The company just may not be able to achieve the necessary cost structure and economies of scale achieved by foreign rivals from low cost regions.

6) What do you think about the company's strategic alliance with Shanghai Challenge Textiles? Is this just a strategic move to exploit a very important market, or is it a betrayal of the company's core values?

At first glance, the deal with SCT appears to be a way of entering a strategically important market. However, this can also be viewed as a move to outsource production to a low wage country. Students can address whether or not this is the

case. Even a company as committed as Malden may not be able to fight the tide forever.

### **TEACHING SUGGESTION**

This case can be used in the traditional manner. Instructors can use the above questions as a basis for initiating class discussion, or they can have students prepare a SWOT analysis. However, perhaps a more creative way of using this case is to have students role-play. Students can play the role of Aaron Feuerstein and his top management team pitching the company to either a group of potential investors, or to the company's creditors asking them to give the company more time. Either the instructor, or other students can play the role of investors or creditors.

## **Manhattan Bagel**

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### **ABSTRACT**

This case documents a profitable company in the food industry, specifically the "take-out sector," spiraling down into bankruptcy. Through an understanding of the strategic management process, the dynamics of the food industry and strategic decisions will be identified as they relate to the company's performance.

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Two brothers, Andrew and Jason Gennusa, set out on the ambitious goal to produce an authentic bagel that even the toughest New Yorkers would love. Creating the combination of a boiled and then baked bagel with just the right "crunch-to-chew" ratio was no easy task, but in 1987 the Manhattan Bagel ® Company was founded. By 1991 they had six Manhattan Bagel ® stores each making their bagels from scratch. Encouraged by their early success, they soon began experimenting with a twist on tradition by offering everything from oat bran and jalapeno bagels, to a wide variety of toppings from bacon and eggs at breakfast to pizzas and deli meats at lunchtime. The brothers now wanted to establish a franchise network but without the duplication of making the bagels from scratch.

Simply put, this new challenge was to develop a production method that would create an authentic New York style bagel every time, everywhere. This meant centralized production facilities where the bagel-making process could be strictly monitored. Using the same time-honored steps as in the last 300 years (legend attributes the bagel to a Viennese baker in 1683), the company would eliminate the need for a professional bagel-maker to produce the perfect bagel. Their signature would be a "potato-chip-thin crisp outer crust and a chewy inner texture."

The company succeeded again, as evidenced by a string of "best of" awards from media in such major markets as Philadelphia, Atlanta, Hartford, Orlando, Albany, and Washington, D.C., among others. From coast-to-coast the word was out that Manhattan Bagel's ® products were excellent.

The company's strategy was to become one of the leading producers of fresh bagels and bagel dough nationally, utilizing the strength of its franchise stores and brand name to create demand for the company's products. Then why did they find themselves in Chapter 11 Bankruptcy in November 1997, operating as a debtor-in-possession? The following discussion revolves around the circumstances facing the company in the two years prior to this action.

### Background

The mission statement of Manhattan Bagel ®:

To support our franchisees in achieving their highest level of success;

To maintain shareholder value by staying committed to quality customer service and effective cost controls;

To provide our employees with the environment that energizes, fulfills expectations, and rewards accomplishment.

The food service industry in general and the take-out sector in particular had been intensely competitive with respect to food quality, concept, location, service and price. "Mom and pop" operators have dominated the industry. Yet national, regional, and local chains operating both

owner and franchised bagel stores have been on the rise. The bagel industry has also witnessed both rapid expansion and entry from large companies not traditionally in the bagel industry, such as Dunkin Donuts ® and Perkins ® .

Manhattan Bagel's ® competitors fall into four categories: bagel and coffee specialty franchises (Brueggers ® , Einstein Bagels ® ); franchises that offer coffee and bagels, though both were not their specialty (Dunkin Donuts ®, 7-Eleven ®, Starbucks ®); coffee and bagel specialty stores that were *not* local regional franchises (mom and pop bagels), and retail venues (supermarkets, specialty retailers.) Intensity of competition varied by geographic region, with the Northeast having had the strongest presence.

Manhattan Bagel ® believed that its most direct competitors consisted of Einstein Brothers Bagel, Inc. ® , Bruegger's Corporation ®, Chesapeake Bagels ®, and Big Apple Bagels ®. Einstein Brothers ® retail system consisted of over 300 owned and operated franchised stores, after the acquisition Noah's Bagels ®. Bruegger's ® owned and operated 100 retail bagel bakeries with over 300 bakeries franchised. Chesapeake ® had 150 units in operation, and the Big Apple® has 144 units.

Start-up costs with opening a retail food establishment offering similar products on a stand-alone basis were competitive with the start-up costs associated with commencing a Manhattan Bagel ® store. Accordingly, such start-up costs were not an impediment to entry into the retail bagel business. This was not the case with competition with the supermarket bagel. These competitors included Lenders, who produced a frozen bagel and a packaged unfrozen variety, and Thomas'

Bagel ®, a prepackaged bagel product. These companies were able to use their brand names to gain advantage in the grocery store. While they were no comparison for the fresh baked gourmet bagel, many people indulged in this easier to get product. On the other hand, Manhattan Bagel ® appealed to the customer's psychological desires. When you brought bagels into work in a Manhattan Bagel ® bag, a higher quality was perceived than if you walked in with a bag of Lender's ® frozen bagels.

The consumer food products industry was being shaped by several factors, including increased consumer demand for healthier food products. Manhattan Bagel ® believed that many American consumers were actively seeking to reduce the fat content and improve the nutritional content of their diet. Bagels have significantly lower fat content and lower cholesterol than food alternatives typically purchased for breakfast take-out, such as donuts, pastries, croissants, or an Egg McMuffin ®. It was management's belief that consumers generally considered bagels to be a healthier alternative. Americans were living longer; notably the baby-boom generation was concerned with health and fitness. Manhattan Bagel ® provided a healthful gourmet fast food alternative. Now the customers could have their gourmet coffee drinks along-side their bagels in a modern, up-scale store.

While competition among the fresh baked had been intense, Manhattan Bagel ® believed there was a great deal of brand loyalty from their customers. Many would go out of their way to get a Manhattan Bagel ® in the morning. Customers also want variety and Manhattan Bagel ® provided 23 different type bagels and various toppings, from eggs to salads.

From the beginning, Manhattan Bagel ® placed great emphasis on product quality in both bagels and cheese spreads, which it believed together with competitive pricing would be the primary factor in a consumer's decision to patronize their stores. The Gennusa brothers believed that controlling the manufacturing and distributing of bagels and cheese spreads was key to ensuring its product quality and thereby maximizing profit. To support this business philosophy and rapid growth, the company expanded its centralized manufacturing capacity and made significant improvements in processing technology and formulations.

Manhattan Bagel ® produced its own bagel dough. The raw materials it purchased included a specially formulated high-gluten flour from either ConAgra or ADM, sugar, salt, yeast, dough conditioners, and other additions such as raisins, blueberries, poppy seeds. Two indoor B silos were stocked from secure port locations on the building's exterior. There were about 3 flour deliveries per week to ensure constant supply and ensuring that the maximum age of the flour was but a few days.

Note: picture of the plant facility will be included in appendix

The plain bagel could take on other flavors from additional seasonings added to the outside of the bagel when the frozen dough was thawed, boiled, seasoned and baked at the individual stores. Specialty items such as pumpkin, cinnamon raisin, or egg bagels were slightly different. With the benefits from flexible manufacturing technology, a batch of specialty products could easily be scheduled when the necessity arose. Specialty items tended to spend longer periods in inventory due to the unpredictability of ordering habits by franchisees. In addition, plain cream

cheese was purchased from independent suppliers and the additional ingredients were mixed in at Manhattan Bagel's ® manufacturing facility.

During 1996, Manhattan Bagel ® opened a new highly automated state-of-the-art manufacturing facility in its corporate headquarters building in Eatontown, New Jersey. Freezer storage space and refrigerated storage space more than tripled. The increase in dry storage space allowed the company the advantage to increase bulk purchase discounts by buying raw goods in larger quantities. The expanded facility gave the company greater flexibility and allowed production to be scheduled in a more efficient manner. The plant operated 20 hours per day, but only four days a week. The Eatontown, New Jersey plant produced over 42,000 bagels and 3,200 pounds of cream cheese per hour.

Plans included constructing a new bagel dough manufacturing facility in the Los Angeles, California to service the West Coast stores. Scheduled to open in May, the West Coast plant was needed to replace a smaller, technologically outdated plant that was acquired during the purchase of I & Joy Bagels ®. Until that time, frozen dough had to be shipped from the East Coast. In 1997, the company began *additional* construction on the Eatontown facility which would double its storage, receiving, and distribution capacity, and would allow it to close its manufacturing plant in Greenville, South Carolina. This addition in capacity was expected to provide the company with the capacity to support up to 625 stores. By centralizing production, Manhattan Bagel ® had been able to mass-produce bagels with greater economies of scale and has systematically reduced costs typical of the experience curve. The frozen bagel, once packaged at the plant, spends two and one-half days or less in the on-site storage freezer before being shipped



out. Cream cheese storage capacity was 70,000 pounds per week; the spreads were packaged and shipped out within one week. While Manhattan strives for a just-in-time system, it kept a buffer of 2 days for its flour, just in case franchisees needed more products than normal.

Since completing the first phase of expansion in Eatontown, the company planned on adding a food technology laboratory to handle research and development, quality assurance, including full microbiological analysis capability. This would give the company more formal control for the thorough evaluation of ingredients, finished products and new product development. There were few steps required to prepare bagel dough and cream cheese; hence locating problems, should they occur, was expected to be straight-forward. As of 1997, the plant test-baked samples from each dough and retained frozen samples to monitor shelf life and performance through the code period. Cheese spreads had a 90-day shelf life. The plant held multiple samples from each batch, testing each batch during the 90-day code period to verify performance

### Principal Stakeholders

Jack Grumet was appointed CEO of Manhattan Bagel ® in April 1991. Mr. Grumet had been chairman and chief financial officer of Banner Financial Services, a wholesale mortgage broker, from April 1989. From 1984 to 1989, Mr. Grumet was involved in a variety of business enterprises. Prior to 1984, he was the founder and chief executive officer of Jo-Ann's Nut House and Chez Chocolat, the nation's second biggest retail franchise chain of nut and candy stores at the time. That company was sold in 1983.

A rumor heard while on tour at the factory was how the Gennusa brothers learned about Mr. Grumet. His wife was a door-to-door sales person who one day found herself at the home of one of the Gennusa brothers. The brothers' goal of establishing a franchise network meant they needed someone familiar with the process. It appeared as if their answers had just landed at their doorstep.

Mr. Grumet's goal had been to increase sales of Manhattan Bagel's ® products by rapidly expanding its number of stores. He pursued this strategy relentlessly, accumulating millions of dollars worth of debt in the process. The growth was phenomenal and the size of the operations doubled annually for the first few years. The family business went public in June 1994 when they completed the Initial Public Offering.

To achieve new store growth, the company sought to license experienced area developers to open multiple units within an exclusive territory; to increase the number of single unit franchises sold directly and through master franchisees; and to accelerate the development of stores within supermarket chains and alternative distribution channels. The total number of stores increased from four on December 31, 1990, to 293 on December 31, 1996. The company had an additional 100 stores in various stages of development as of December 31, 1996.

Manhattan Bagel ® provided field support services to its franchisees to help them maximize business and financial management, acquire local market area penetration, maintain quality control and customer service excellence, stay abreast of new product developments, provide addressing services, and to allow the franchisee the opportunity to share new ideas with the

company. Advertising provided by Manhattan Bagel ® was a joint effort between franchisees and the company. The bagel dough and cheese spreads required to be purchased from Manhattan Bagel ® in the franchise agreement, and were provided for a fee. Franchisee paid a royalty up to 5% of their gross sales and a cooperative ad fee from 2.5% up to 4% of gross sales.

Note: picture of a franchise will be included in appendix

Prior to opening a new store, all franchisees went through Manhattan Bagel ® University, a two-week training program run every month by the company. This included one-week of classroom training in marketing, administrative record keeping, inventory control, and one week of training in baking and food preparation. This program was also available to employees of franchisees. The company had an 1100 square foot fully equipped store located inside company headquarters, which served as an operational training center. According to Lord, "Though Americans were dining out more than ever—spending an average \$970 million day—a sweeping new survey suggests that a significant number were enjoying it less." Service was key to building clientele and surpassing the competition. Manhattan Bagel ® incorporated this message into all training.

The company also provided on-site personnel for each store's grand opening. Afterwards, the regional franchise consultants monitored operational results, visited stores for consultation and provided advice based upon the franchisee's experience. Weekly sales were monitored and attempts made to provide operational assistance if needed. For example, if a store location was operating below break even, franchise services intervened to negotiate more favorable rent with the landlord. The new image of Manhattan Bagel ® with its slogan "America's Most Wanted

Bagel," had helped with the franchise value. Public image was as important as products, advertising, service and support.

The company and its franchisees advertised products in newspapers, through direct mailings, and on radio and television. Advertising was primarily funded out of the required contribution to the company's regional advertising cooperative by franchisees. The company's "Co-operative Advertising" program provided support in the form of recommended advertisements, advertising formats, community cash-back programs, gift certificates, "Dozen Club," direct mail, and focused local store marketing programs. In 1996, the company used cooperative advertising funds to air a television commercial in selected New York, Pennsylvania and Connecticut area markets on network television channels.

Master franchisees helped the company develop new territories, such as the territory consisting of the states of North Carolina, South Carolina, and Georgia. A master franchisee was responsible for selling franchises, finding locations, negotiating leases, supervising the design and building of new stores, supervising franchisees after the locations were opened, all in accordance with the company's quality control guidelines. Current master franchisee agreements provided for a negotiated payment fee by the master franchisee, which was based upon the population of the territory covered. The master franchisee was responsible for soliciting the initial franchise fee and royalties from each franchise in the territory. The master franchisee retained two-thirds of the fees and royalties with the remainder going to headquarters. Company owned stores were built and run by Manhattan Bagel ® until the franchise method began

In an effort to speed-up the franchise base, the company established an in-house construction department and began building new stores before qualified franchisees had been found. Often, they could not find an interested buyer and the location turned into company run stores which proved not to be profitable. The few franchisees they did find were begun in financial trouble due to high debt service and unrealistic sales projections that never materialized.

Some business deals that were made that were just plain careless and lacked common sense. One such bad deal involved entering into an area development agreement with a company in upstate New York. Under the agreement, Manhattan Bagel ® would lend the area developer investment funds. In return the developer would establish new stores in the area, while simultaneously paying a percentage to Manhattan Bagel ® from sales while also repaying the loan. Without having proper collateral documentation signed, Manhattan Bagel ® disbursed the money. There was no signed promissory note, no security agreement, no UCC-1, and no mortgage. To date, the company was still in court trying to recover their initial investment that would not be the case if they had followed proper business practice and due diligence.

Manhattan Bagel 's ® strength was the United States, and expansions focused on permeating gaps in this market. However, there were some areas being developed outside the US, as a way of testing the global waters. Manhattan Bagel ® had operations in Canada, and was currently establishing a licensing agreement for locations in Iceland, Germany and Israel. Consider the master franchise deal with Israel. The master franchiser, International Management Ventures (IMV), was expected to open at least 15 stores over the next 5 years. This new venture must take into account the religious implication in this country: bagel dough and cheese spreads must be

kosher; food handling and preparation must be exact; tastes and preferences need to be determined. Along with IMV's Israeli affiliate, MBI Restaurant Group, Ltd., plans called for developing a nation-wide network with a wholesale operation aimed primarily at Israeli supermarket chains. MBI should be able to assist IMV with access to local knowledge and an entranceway through political redtape.

Jason Gennusa, president of Manhattan Bagel ®, has been committed to providing the consumer with superior quality products combined with excellent service in a clean, pleasant environment. This attitude that the customer comes first was instilled in all employees. Despite this attitude, there were no customer comment cards at the stores. However, the company managed to keep up with the trends demanded. The Lunch Program best exemplifies the customization of products and services. This was started to give customers a variety of toppings for bagels, as well as soups, muffins, gourmet coffees, and hard rolls. The introduction of new flavors such as jalapeno cheddar, sourdough, and orange-cranberry was meant to obtain markets in the south and west.

In another effort to increase sales, the company implemented a multifaceted re-imaging program in 1996. This program included an advertising campaign promoting Manhattan Bagel ® Company's as "Americas Most Wanted," employed in radio and print ads. In addition, the company created a new corporate logo and a new store design highlighted by a colorful, full-length wall mural especially commissioned, utilized in all newly constructed stores. Elements were instated in the company's existing franchised and company-owned stores.

The owners believed in marketing and selling its products in association with national and regional chain stores. Co-branding offered an excellent way to expand distribution. Co-branding arrangements ranged from over-the-counter sales of the company's products by a chain store, in-store kiosks to display and sell the company's products, or opening a Manhattan Bagel ® Company store, either owned or franchised, in association with a chain. The company continued to develop new carts, kiosk, and other branded display formats. It believed that its methods of manufacturing and shipping frozen raw bagel dough to these retail outlets provided the necessary flexibility and simplicity of operation to expand distribution within this broad range of retailing environments.

There was a cross-functional integration between Research & Development (R&D) and Production. In Manhattan Bagel ®, R&D handled quality assurance as well as new product development. Through this integration, new products were produced faster and with the highest quality attainable. To obtain open communication, the R&D department was located in the new addition at the Eatontown manufacturing plant. This was meant to encourage R&D and manufacturing to work closely together.

When rolling out their new Lunch Program, which consisted of new sandwiches and rolls, teams were organized. Pay was not linked to group or team performance since these teams were only temporary. In setting goals and creating incentives, factory workers received a plaque after one year of service. There were non-monetary rewards for office workers. Employees were encouraged to give suggestions through a suggestion box. During this time teams were developed which worked through the idea generation, product refinement, project execution, and

to market. The Lunch Program proved to be successful for the company and appeared to generate unification. As they diversified their menu to keep competitive, they risked hurting overall bagel sales by offering wraps and soups.

Manhattan Bagel ® had several strategic partnerships and promotional campaigns with large suppliers such as Kraft foods, Boars Head, Coke and Pillsbury. These suppliers recognized the marketing strength Manhattan Bagel ® had to promote their products, and priced favorably to insure an ongoing, positive relationship. They also realized that Manhattan Bagel ® purchased in large quantities around the nation. There may be many available lunchmeats and cheese vendor substitutes, but brand name recognition and quality made these alliances a win-win situation.

Manhattan Bagel ® provided customers with a fresh reasonably priced product. In addition to the bagel, they provided coffee, juices and soft drinks. The communities in which the stores were located attract a respectable clientele. Most customers took their bagels away with them. The stores in the suburbs were closed early so there was not a problem with people "hanging around" at night. The stores were well maintained and up-scale with a definite eye appeal. All stores were expected to be in compliance with federal, state and local government regulations. Failure to comply would have an adverse effect on the company. In compliance with the Federal Trade Commission (FTC), the company must prepare and periodically update a comprehensive disclosure document known as the Uniform Franchise Offering Circular (UFOC). The company believed that its UFOC, together with any applicable state versions or supplements, complied



with both the FTC guidelines and applicable state laws regulating fronting in those states in which it operated.

Besides franchisees, there were some area buyers, such as Giant Foods, a huge account in the Maryland-Washington DC. These buyers purchased specially formulated dough from the Paragon Bakeries Division, the wholesale division of Manhattan Bagel ® servicing outside accounts. Should Giant Foods be lured away, it would have a great impact on the company. These accounts were very profitable in utilizing the excess manufacturing capacity, since they spread the fixed operating costs thus lowering per unit cost of bagel production. Paragon Bakeries had its own "parbake" bagel, which was different from the recipe sold to franchise stores. No one could get a Manhattan Bagel ® except directly from a Manhattan Bagel ® store.

The company had been considering expansion of its distribution through major foodservice contractors in nontraditional retail environments such as college campuses, military bases, hospitals, airports, convenience stores, and food court on toll roads. An agreement was already in place with ARAMARK Corporation providing the Company's franchisees the right to place Manhattan Bagel ® cases on college campuses serviced by ARAMARK.

Local area distribution was performed by the company's own trucks. The drivers and the support staff were on the Manhattan Bagel ® payroll. Routing schedules were developed but needed constant monitoring. An advantage to doing its own distribution was the ability to get information on store purchases and providing this feedback to franchise services; a failing store could then be recognized in its early stages. Stores outside the local area received distribution

through outsource companies such as Marriott Distribution Services. When utilizing a large distributor, many headaches were eliminated. Collection of receivables was limited to one central account versus 130 mom and pop store contracts. Damages and returns were noted in large quantities vs. 130 line items. Also, large distributors had the IT and staff that specialized in routing, scheduling and transportation related issues. Manhattan Bagel ® did not this expertise.

In addition, the company needed to improve methods of data collection of store level information that was crucial to upper management planning. The company relied on each store to fax their sales into headquarter weekly. The company billed for royalty and advertising based upon what the store reported. This system was extremely antiquated, frustrating, and backwards considering today's technological environment. Polling through store registers needed to be implemented to insure timely gathering of sales information, timely and accurate billing and collection cycles, sales forecasting, and cash flow projections for budget purposes.

### Acquisition

Manhattan Bagel ® purchased I & Joy Bagels ®, a private company, which owed and licensed 17 bagel stores in Los Angeles. In the stock deal, Manhattan Bagel ® got not only the stores but also two 30-year-old executives who ran I & Joy Bagels. Allen Boren, who became one of Manhattan Bagel 's ® largest shareholders, was named chairman and chief executive officer of the Los Angeles stores, now a wholly-owned subsidiary of the company. The other executive, Eric Cano, was named president. Court records would later indicate that Mr. Boren and Mr. Cano had past dealings, never indicated in the prospectus, that might have given investors a

second thought. First, there were the huge gambling losses that the two men had accumulated in Las Vegas. Second, there was the manner in which casinos had been paid in the past—with bad checks. This is not exactly endearing behavior for corporate fiduciaries.

In addition to their bagel stores, Mr. Boren and Mr. Cano owned a small concern called Charworth Plating Company. Metal plating involves hazardous substances; everything from chromium to cyanide which California law imposes disposal restrictions. According to a criminal complaint against them, Charworth simply got rid of its poisonous muck down a storm drain during 1994.

Jack Grumet was aware of the casino lawsuits against Mr. Boren and Mr. Cano, yet his zeal to expand the number stores led him to accept Mr. Boren and Mr. Cano's explanation that the checks were forged and the debts not theirs. Mr. Grumet felt that these issues were not significant enough to affect the deal for I & Joy Bagels. Whether he did not know or did not care to know that these gentlemen were facing felony charges involving toxic waste is a matter of speculation. In any case, Mr. Grumet exercised poor judgment by not scrutinizing the accounting records before entering into an agreement. At the very least, the sale should have been contingent on all records being proved accurate. The first day the news of financial irregularities hit the market, the stock price dropped from 21.25 to 13.75.

Note: Newspaper articles to be placed in an appendix along with financial data.

Even though these irregularities were a matter of public record available to anyone who did some research, Manhattan Bagel ® allowed these two men to operate the West Coast stores.

Manhattan Bagel ®' stock dropped 35% in June 1996, after the chain said it would lower first quarter earnings results because of accounting irregularities at its West Coast unit. Manhattan Bagel ® uncovered improperly recorded franchise fees; payments made for purported public relations work, real estate diner's fees, inflated receivables and inventory. The company estimated the amount to be about \$350,000 on a pretax basis. In an admission that might have frightened investors, Manhattan Bagel ® stated that an operational review by the new management at I & Joy suggested its contribution to net income would not meet the expected high. In the midst of this confusion, the company continued expansion and accumulated substantial debt.

A class action lawsuit was filed against Manhattan Bagel ®. The suit alleged that the true financial operating condition of the company remained recklessly concealed from the investing public by upper management. On May 15, 1996 the company issued a press release that reported "record net income of \$869,615, \$.12 per share for the 3 months ended March 31, 1996, a 403% increase from the \$172,275, \$.03 per share in the first quarter 1995." Suddenly after close of business on June 20, 1996, the company stated that it had uncovered certain improprieties and accounting practices concerning only the I & Joy subsidiary in the two most recent quarters. The company's independent auditors Ernst & Young, LLP had advised the company that based on its findings, they would be required to restate the first quarter 1996 Statement of Operations. The restatement would reduce total revenues from \$8,194,904 to \$8,104,904 and record \$260,000 of additional expenses. Based upon these adjustments, EPS would drop from \$.12 to \$.09.

At the time of this announcement on June 21, 1996, 6,700,000 shares of MBC stock traded hands with an opening price of \$28 per share and closed at \$13.75 per share. The accounting effect on

the overall financial position of Manhattan Bagel ® was minimal, but once large investors heard the words "improper bookkeeping," it prompted them to sell. The impact was felt hardest by the small investors who would eventually lose all.

### Epilogue

The lawsuit alleged Manhattan Bagel ® management's acts and conduct, including the preparation, issuance and dissemination of materially false and misleading information to the investing public was done to inflate the value of the stock and give the company more leverage in acquisitions. The bagel franchiser had no choice but to file for bankruptcy protection. Before the acquisition of I & Joy Bagels, Manhattan Bagel ® was making a profit, product sales were good, franchise and licensee-related revenue was high.

While still operating under bankruptcy protection, management sought to find a buyer.

Manhattan Bagel ®, as of July 29, 1998, was acquired by New World Coffee, a company with many obvious synergies. Under the acquisition New World Coffee provided up to \$3.5 million for Manhattan Bagel 's ® secured creditors, provided \$11.5 million for Manhattan Bagel 's ® unsecured creditors, and assumed up to \$5 million in additional liabilities. No value was provided to Manhattan Bagel ® equity holders. The agreement covered the acquisition of Manhattan Bagel 's ® approximately 310-store franchise system, two-bagel dough manufacturing plants, and corporate operations. At the time New World Coffee consisted of only 43 stores.

## Teaching Note (TN)

### 1. Overview and Instructional Purpose

This case documents a well-known profitable company in the food industry, specifically the "take-out sector," spiraling into bankruptcy. Through an understanding of the strategic management process, the dynamics of the food industry and their impact on a company's success are reviewed.

This case was developed through newspaper, magazine and Internet articles noted in the reference section of the Teaching Note (TN) and information gained from a tour of the factory

The decision focus in this case is: How did a profitable company end up in Chapter 11 bankruptcy in November 1997, operating in a debtor-in-possession?

### 2. Learning Objectives:

This case will enable students to:

Understand the strategic management process in application

Review Michael Porter's conceptual Five Forces Model as well as Groves 6<sup>th</sup> force: the role of complementors

Evaluate the dynamics in the food industry and identify a company's position within the food industry

Identify issues and patterns in a company's strategy

Perform a SWOT analysis and identify how a company reacts to opportunities and threats within its industry.

Discuss competition in relation to gaining market share

Review the leadership role in strategy

Understand a company's situation and consider alternative strategies

Problem solve

Present a leadership strategic decision

3. Principal Stakeholders:

- a. Jack Grumet – CEO, appointed 1991; former chairman and CFO of Banner Financial Service, a wholesale mortgage broker; founder and CEO of Jo Ann's Nut House and Chez Chocolat sold in 1983
- b. Mrs. Grumet – wife of Jack Grumet and door-to-door sales person
- c. Jason Gennusa – president Manhattan Bagel ®
- d. Andrew Gennusa – co-founder of Manhattan Bagel ® with his brother
- e. Investors-shareholders
- f. Suppliers and vendors
- g. Production employees
- h. Franchisees and personnel
- i. Customers
- j. Allen Boren-major shareholder, chairman and chief executive officer of I & Joy Bagel, Los Angeles stores; owned Charworth Plating Co; facing felony charges involving toxic waste; has gambling losses; casino lawsuit for bad checks

- k. Eric Cano, President, I & Joy Bagel; co-owner of Charworth Plating C and also facing possible felony charges involving toxic waste; has casino lawsuit for passing bad checks for gambling losses.
  - l. Strategic Partnerships: Kraft Foods, Boars Head, Pillsbury
  - m. Master franchiser- International Management Ventures (IMV)- 18 stores to open in Israel in next 5 years
  - n. IMV's Israeli affiliate, MBI Restaurant Group. LTD
  - o. Buyers – i.e. Giant Foods of Maryland
  - p. Paragon Bakery - a division of Manhattan Bagel ®
  - q. ARAMARK Corporation-provides Manhattan Bagel ® the right to place bagels on college campuses serviced by ARAMARK
  - r. New World Coffee – acquired Manhattan Bagel ®
4. The case has a practical link to theory:

Critical issues that can be discussed are expansion strategies, competition, ethics, financial irregularities, and Chapter 11 bankruptcy. These issues have often been linked to business realities. Unfortunately, these negative issues have been too common a theme in the newspaper and continue to be timely issues for students.

5. Suggested discussion questions and answers
- a. SWOT



- i. Strength-high quality, fresh reasonable priced product, healthy bagel with reduced fat and low cholesterol, consumer brand loyalty, brand name recognition, positive partnerships, positive marketing campaign, attractive upscale stores and clientele, variety (23) of product line (Product Line- bagels and toppings: oat bran, jalapeno cheddar, sourdough, orange cranberry) along with juice, soups, muffins, gourmet coffee, hard rolls, soft drinks, new sandwiches, bacon and eggs, pizzas and deli meats at lunchtime; keeps up with trends; competitive pricing, controlled manufacturing and distribution of product, centralized production, with economies of scale, just-in-time system inventory control, marketing strength in U.S. market; customization of products and services; multi-faceted re-imaging marketing campaign; quality production teams; Employee Lunch Program
- ii. Weakness- old system and process results in poor data collection at the store level, untimely sales information, cash flow projections, questionable corporate behavior by Eric Cano and Allen Boren, financial irregularities, unrealistic expansion projections; non-monetary reward incentives for employees; diversification of product line; production usage capacity.
- iii. Opportunities- increased customer demand for healthy food products, product appealing to upscale busy clientele; international marketing opportunities in Canada, Iceland, Germany, Israel; diversifying product line; expansion in nontraditional retail environments (colleges, military bases, hospitals, airports, convenience stores, food courts).

iv. Threats

1. Internal-

- a. Questionable corporate behavior
- b. Unrealistic strategic expansion goals
- c. Financial irregularities

2. External-

- a. Class Action Suit against Manhattan Bagel ® alleged that financial operating conditions of company recklessly concealed from investing public by upper management.

b. Competition

- i. Bagel and coffee specialty franchises (Brueggers, Einstein Bagel, Big Apple Bagel)
- ii. Franchises- (Dunkin' Doughnuts, 7 Eleven, Starbucks)
- iii. Specialty Stores (Mom and Pop stores)
- iv. Retail Venues (Supermarkets with products: Lenders, Thomas)

- b. Define the following terms: Chapter 11, bankruptcy, debtor-in-possession, escalating commitment.
- c. Discuss Porter's Model regarding Manhattan Bagel's place in the food industry.
- b. What is the level of competition in the take-out sector?
- c. What was the company's strategy over the course/time period of this case?

- d. Describe the evolution of the company's expansion?
- e. Do you agree or disagree with Andrew Groves comment that a sixth force of "complementors" is an added value to a product line? Why or why not?
- f. How do you maintain shareholder value and stay committed to quality customer service?

6. Winning Strategy/Summary

To be listed after small group presentations and discussed by class

7. Epilogue

To be distributed after students' discussion

8. Recommended Subject Area, Level, Teaching Pedagogy:

- a. Level: Case can be taught at undergraduate or graduate level
- b. Course(s): Strategy, Marketing, Investment, Production Operations Management
- c. Teaching Pedagogy:
  - i. Small groups: After a class SWOT analysis, divide the class into small groups.
  - ii. Role-Play: Have the groups assume leadership roles in Manhattan Bagel ® and ask the groups to pose alternative strategies that Grumet could have pursued. Have the group's role play different company leadership roles. Discuss what could have been done to prevent the downward spiral into bankruptcy.

9. Suggested resources for teacher

- a. Bring in bagels
- b. Articles from newspaper
- c. Bagel-making film available through American Institute of Baking
- d. Bring class to a bagel plant and/or bagel store for local color. Discuss case while enjoying bagels and coffee
- e. Read Porter's Competitive Advantage
- f. View Manhattan Bagel 's ® marketing ads

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11. Follow-up Case for 2005 Case Conference:

Continue with the Gennusa Brothers and the acquisition of Manhattan Bagel ® by New World Coffee to the present time.

## **Moment of Truth**

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### **ABSTRACT**

This case involves the decision of a senior officer at a securities firm to blow the whistle on insider trading at the firm. Discussion points include: internal vs. external whistleblowing; the extent to which an individual might go to assemble evidence of wrongdoing; the risks of whistleblowing; and elements of effective whistleblowing. At the end of the (A) portion of the case, students should be able to make and defend a decision regarding their obligation. At the end of the (B) portion, students should be able to discuss the risks of whistleblowing, as well as the elements of effective whistleblowing.

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They were exchanging pleasantries at the door. “Thanks, Joel, for the drinks and dinner. And thank you, Anne. I’m very glad I got to meet you. Joel is great, and I can certainly see where he gets his strength. Anyway, see you on Monday, Joel. Another day, another million dollars!”, he chuckled. And with that, Christopher Reuther shook Joel’s hand and stepped into the hall, heading to the elevator. It had been a short visit, drinks and dinner, before Christopher headed out for a date. But in that short time, Joel had confirmed his worst suspicions. As Joel snapped the lock, he contemplated his next step.

Joel Steiner was 37 years old, a strong family man. He had been raised in a family where honesty, integrity, and a strong sense of family were important, and he continued living with those values. He was just moving into the prime of his career. He had risen steadily from his college days at Metropolitan College in New York City. There, he had earned his B.A., and been elected treasurer of the student government. Later, he had earned his M.B.A. at Metropolitan, taking night classes, and had his C.P.A. license.

In 1984, Joel was named vice-president at Landis Investments, in charge of taxes and financial planning. He left that job when a few other senior partners from Landis started a new firm, Meridian Partners, where Joel served as C.F.O. It was there he had come to the attention of Adam Hagerman. And it was there he started the journey to the difficult choices he now faced.

Adam Hagerman was a strong-willed military man, with a mixed reputation on Wall Street. He was demanding, known for firing associates with little provocation. He had been investigated by the Securities and Exchange Commission (SEC) on several occasions. In his last investigation, he had almost been given a lifetime ban from the industry, but instead had received a year's ban from trading.

He was president of Hagerman Associates, a New York Stock Exchange (NYSE) Specialist and arbitrage investment firm. He had joined the firm in 1964, after a career that included stints at Goldman Sachs and a smaller Wall Street brokerage firm. The specialist side of Hagerman Associates was run from a trading post on the floor of the NYSE, with five traders, and clerical staff. From that post, the traders "made a market" in the stocks the NYSE had delegated them to trade. In making a market, the traders seek to profit on the spread (the difference between the purchase and sale price). There are no outside investors in a specialty firm. Rather, the money financing the trades consists of the investment money of each partner, contributed to a common fund when they join the firm. Hagerman Associates had an investment fund of about \$40 million.

The firm's arbitrage trading portfolio activities were conducted in an upstairs trading room, where six people worked as the arbitrage trading team. In contrast to the trading side, there were no limits on what stocks the firm might trade in. Profits in arbitrage were the result of the spread between the current stock price of a firm that was projected to be taken over, and the



eventual takeover price. Due to the inherent risk in the takeover being consummated, there is a spread between the trading price and the takeover price, proportional to the amount of risk in the deal. Steiner worked in this room, along with Jason Witter, the head of trading, Christopher Reuther, and several clerical personnel. Hagerman came and went.

In 1984, Hagerman approached Steiner with a partnership proposal. He would make Steiner a partner, providing a substantial base salary, along with a share in the profits of the firm. Steiner's position would be C.F.O. and compliance officer. The duties of a Wall Street firm's compliance officer consist of monitoring the trading and arbitrage activities, assuring that the firm employees abided by the regulations of the SEC, as well as the other relevant exchanges.

The SEC takes the integrity of the markets, and hence the responsibilities of all traders and compliance officers seriously. If a trader is dismissed from a firm for cause, that dismissal and its cause has to be filed with the SEC on what is known as a "U5" form. The U5 form follows the trader throughout his or her career, and would be accessed by future employers as part of their hiring investigation. One of the compliance officer's responsibilities is registering U5 forms. The SEC holds compliance officers responsible for any infractions that occur during their tenure, regardless of their current job.

Adam Hagerman's previous investigations by regulatory authorities gave Steiner deep reason for concern. In order to confirm or deny his fears, Steiner undertook a series of meetings with individuals who had known Hagerman over several years. His friends assured him that Hagerman had indeed learned his lesson, and was now managing an honest organization.

Christopher Reuther, one of the new hires, worked in the arbitrage room next to Jason Witter. Christopher was 27, handsome, lean, very bright, and lately, very talented. In the past few weeks, Christopher had recommended a number of stocks that had been bought out shortly

after Hagerman Associates took a position, reaping huge profits for the firm. Just that February, Reuther had convinced Hagerman and Witter to take a position in Graham Toolworks, a stock Steiner himself had tried to push through some months earlier. Steiner's recommendation had been rejected. At Reuther's recommendation, based on his friend's word, Hagerman and Witter bought 20,000 shares. One short week later, Graham Toolworks was bought out, and Hagerman Associates was a much richer firm.

Reuther's latest hot stock was American Brands, a tobacco firm. He touted it as one he was sure (based on his same friend's word) would be bought out in the next couple of weeks by B.A.T. Industries, a large British conglomerate.

Steiner was amazed. Reuther had been with Hagerman Associates for only five months, and this could be one of the largest arbitrage deals that year. And Steiner, who had worked on Wall Street for years, had not even heard of the possibility of this deal before – no rumors, nothing. Where did the information come from? Who was this friend?

That same day that Christopher had touted the B.A.T. play, he stood by Steiner as Steiner scanned the Dow Jones and Reuters tapes. Steiner looked over and asked Reuther what made him so strong on B.A.T. Reuther simply replied, "Because it's my friend." Steiner replied, "There are friends and there are friends. What makes this one so special?" Reuther responded, "This guy gave us Transway International, General Foods, and Carbide." Steiner knew that each of those had been home runs for Hagerman Associates. But Steiner was curious, so he asked, "Why are you so sure of him now?" And then Reuther dropped the bomb: "Because this is my friend at Koplek and Wright."

Koplek and Wright was a respected international law firm, not a name casually dropped. A leak at Koplek and Wright was unusual, to say the least. But if that is where the information

was coming from, Reuther should have been confident. Any information leaked from there was bound to be rock solid.

Steiner did not have to wait long to discover the identity of Reuther's "friend". Reuther talked, all too often, to too many, both inside and outside Hagerman Associates. That trait had always concerned Steiner, and now it terrified him. Who else knew what was going on at Hagerman Associates? But now it served his purpose: Reuther left the floor to talk to Dennis Pfaff, who had called for Reuther. Dennis Pfaff, it turned out, was employed at Kopler and Wright.

It was clear that Reuther was trading on inside information. Insider trading, as it is known, has been illegal since passage of the securities laws of 1934, but never clearly defined. Rather, the law simply makes trading on material, nonpublic information illegal, but fails to specify what passes for material, nonpublic information. Rather, court cases have been used both to define what passes for inside information, and who is liable for possession of it. It was apparent to Steiner that this information passed a rule of thumb test: the information was determinative in the decisions to trade in the stocks, and the tender offers had not yet been disclosed publicly. The fact that these trades involved tender offers actually violated a later section of the securities laws that specifically prohibited trades on inside information on tender offers.

Steiner now had two objectives. Firstly, he wanted to have tangible proof he was not involved in these illegal trading activities. Secondly, he wanted to know more about who was involved, and how this entire chain of information functioned.

His plan was simple. He would invite Reuther over to his home, engage him in conversation, and get the information he needed. Reuther had an engagement later that Friday

evening, so Steiner and Reuther agreed to an early drinks and dinner at the Steiner apartment. Earlier that week, Steiner bought a small tape recorder.

Reuther showed up a bit before six, and they began with standard cocktail banter. When the talk moved to the arbitrage business, Steiner took the moment to probe the recent spate of profits at Hagerman Associates. As he started this conversation, he hit the “record” button on the tape recorder. It had been a boom market, to be sure, but Reuther’s streak had been phenomenal, Steiner noted. And this Dennis had certainly helped.

“It’s just unbelievable what he does!”, Reuther agreed. “He’s a second-year associate at Kopler and Wright. He knows this guy at Drexel, Ray Criton, who’s my friend. ... Ray introduces him to me, Ray introduces him to other friends...”

“We got Graham Toolworks through him,” Steiner said. “What else?”

“Carbide ... American Brands.”

“If he’s right, American Brands will just be enormous.”

“But it’s not just Kopler and Wright,” Reuther boasted, “he has a roommate at this other law firm. His roommate brings work home occasionally. They talk, he looks at his roommate’s work when the guy goes out.”

Steiner returned to Dennis Pfaff and Kopler and Wright. If Kopler and Wright used code names for work in progress, how did Pfaff know so much?

“He broke that,” Reuther confided. “He made friends with the word processors. We were out one night, and went back to his office to get some papers from word processing. He just went in and talked to the typists, like, ‘What’s going on tonight?’ It’s his way of finding out if certain partners are in. Then we just went to the Xerox department and snooped.”

“Did you know him at school?”

“No, he was real Ivy League stuff. If he gets an arbitrage job, he’ll be hot. He has an M.B.A., and he really knows his stuff.”

Steiner looked at his drink. “You know, what he’s doing, it’s pretty rare. This doesn’t happen often.”

“Yeah, I told him we have to cool it,” Reuther agreed. “I’ll make sure he doesn’t call me during the day, just see him in the evening or on weekends.”

“This is pretty wild.”

“He only tells a few arbs.”

“Us, and some others, right?,” Steiner asked.

“Criton...”

“You, and you tell Adam and Jason,” Steiner continued, laughing nervously.

“Yeah,” Reuther agreed, pleasantly implicating Hagerman and Witter.

The conversation wound down from there, and it was time for Reuther to leave. In the twelve minutes of tape, though, Steiner had what he needed. They parted at the door, Reuther to his evening, and Joel and Anne Steiner back into their apartment, mulling over the next steps. The first two objectives had been all too easy to accomplish. Choices made now would dictate how much harder it would get.

### **MOMENT OF TRUTH (B)**

As Reuther walked to the elevator, Steiner snapped the lock, and thought, “Now what?” He had proof that he was not involved. He also knew that Hagerman and Witter knew they were

trading on inside information. He had every reason to believe that this illegal trading activity would continue. As compliance officer, Steiner was square in the middle of the whole mess.

Steiner had four options.

- *Act like he knew nothing.* He would resign quietly, get his money out of the partnership, and move on. If no one ever got caught, he would be good as gold. If the trades came to light, though, the SEC would look to him as compliance officer, and he would be in deeper than he was now.

- *Go to Hagerman, and tell him Reuther was trading on inside information.* This had the ring of a suicide mission. He had every reason to believe that Hagerman not only knew what was going on, Hagerman was in full agreement with the insider trading. Steiner could kick himself: why had he ever believed that Hagerman had changed? He too readily accepted the word of those who had said Hagerman was really different after the last SEC investigation. Steiner began to wonder what he was like before, if this was ‘different’.

- *Report this to the SEC anonymously, and then act shocked in front of Hagerman when the SEC called.* But that would be the problem: the first call the SEC would make would be to Steiner. His role as compliance officer meant he served two masters, the firm and the SEC. The SEC would want to know what he knew, when he knew it, and how he could miss the telltale signs Reuther had left for all to see.

- *Report openly to the SEC.* He would have to resign immediately. Hagerman Associates was too small to even think he could go back to work there. His money in the firm would be at risk. It was unthinkable to imagine that Hagerman would return that without a brutal fight. It would be hard on Steiner, and hard on his family.

But Steiner's thought was simple. He could survive blowing the whistle. He could not survive an SEC indictment. His wife's thought was equally simple. She could live with hardship. She could not live with a husband heading for jail. The way out led straight to the SEC.

There was work to be done before making that call, though. The first thing Steiner wanted to happen was that the trading should stop. That meant plugging the leak at Kopler and Wright, something that turned out to be easier than he thought. He knew that one of the partners at Kopler and Wright was Frank Weber. Weber's reputation in New York City and worldwide was immaculate. That Sunday following Reuther's visit, Steiner called a mutual friend of himself and Weber, and said he needed to get to Weber immediately.

That Sunday evening, just 48 hours after Reuther's visit, Weber was sitting at the Steiners' table, listening intently to the tape. Weber, more furious by the minute, scribbled rapidly on his yellow pad. When the tape ended, Weber shook his head, muttering how this had never happened in his entire career at Kopler and Wright. He had to go straight to the district attorney for Manhattan.

Steiner bargained for time. He did not have a lawyer yet, and he wanted to get that in place before this broke. The first thing that had to happen was to plug the leak, Steiner argued, and he urged Weber to get Pfaff sent anywhere else in the world – just not Manhattan for a while. Weber agreed. Pfaff would be on a plane to London. Weber made a quick phone call to another partner in the firm, and Pfaff was packing his bags, unaware that his world would be very different when he returned from London.

That Thursday, Weber was back on the phone with Steiner. Steiner still did not have a lawyer, and had not yet come up with anything past resignation from Hagerman Associates. The

clock was ticking. Not only was Pfaff due back over the weekend, but Weber had violated his obligation to go to the authorities as soon as he knew of the problem. Steiner argued a very reluctant Weber into giving him a bit more time.

Finally, two days later, on Saturday, Steiner talked to Joe Tillman, a lawyer. After a day of extensive discussions, Steiner and Tillman met on Tuesday morning with the regional administrator of the SEC, played the tape, and detailed the entire operation in the arbitrage unit of Hagerman Associates.

Following that meeting, Steiner returned with Tillman to Tillman's office. There, Tillman proceeded to take two actions. First, he sent Steiner's letter of resignation to Hagerman, requesting the return of Steiner's capital and bonus. Then, Tillman called Weber to inform him that Steiner and Tillman had been to see the SEC.

With the SEC informed, Weber called the U. S. District Attorney. They picked up Christopher Reuther on Wednesday. Under intense questioning, Reuther admitted to every charge. The Attorney's office offered him a deal: if Reuther would wear a wire and get Pfaff to admit guilt on tape, they would be lenient down the line. Reuther agreed.

Steiner knew Hagerman would fight, but Friday was a real shock. In the business pages of the New York Times was an article describing the charges that had been levied at Reuther and Pfaff the day before. In that article was Steiner's name, and a full description of his role in providing the original tape. He expected trouble from Hagerman, but the government had given him up!

On Wall Street, Steiner was anathema. Some of the kinder words described him as "clown" and "asshole". Few, if any, publicly defended Steiner's actions. There were even



rumors that Steiner was trying to blackmail Hagerman. The Street had always been tough, now it was turning mean, and personal.

Criton and three others who were also in the “information loop” were arrested one month later. Along with Reuther and Pfaff, this made six arrests, each under 30 years of age. Five received sentences of probation, community service, and fines. Dennis Pfaff, the central figure, was sentenced to jail. All received a lifetime ban from the securities industry.

Hagerman and Steiner entered into arbitration proceedings at the NYSE over Steiner’s claims against Hagerman Associates. Finally, the panel ruled for Steiner, demanding the firm return in full his invested capital.

One year later, Hagerman Associates was found guilty of two counts of securities fraud, paying a half million dollars each in fines to the NYSE and SEC. Witter was cleared of all counts against him, and Hagerman was named an unindicted co-conspirator. Hagerman had maintained a “Sergeant Schulz”<sup>119</sup> defense, claiming he was in and out of the arbitrage room and never knew that insider trading was in fact occurring.

Steiner’s life slowly picked back up. He opened his own consulting shop for a while, and subsequently went to work at several large hedge funds. He was right on one count: he survived the whistle blowing. But he’s a lot more careful now.

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<sup>119</sup> A character on the “Hogan’s Heroes” comedy program, whose line was “I see nothing. I hear nothing. I know nothing.”

## **Moment of Truth**

### *Instructor's Manual*

#### Case Overview

This case is based on a real incident, and the details of the writing substantially reflect the event as it unfolded. The authors conducted a research of relevant news reports, and a series of interviews with the real “Joel Steiner” to develop the case as written here. Certain details regarding Steiner and his position have been inflated to emphasize the cost of the impending decision, and generate strong discussion in the classroom.

(A) Portion. This portion deals with events surrounding a decision by Joel Steiner to blow the whistle on an insider trading scheme that was occurring at the trading firm where he was employed, Hagerman Associates. Hagerman Associates was a partnership, headed by Adam Hagerman. The firm operated on Wall Street, doing a mix of trading and risk arbitrage. On the trading side, the firm made markets in a specific set of stocks assigned them by the SEC. On the risk arbitrage side, the firm took equity positions in firms they believed were soon to be bought out or merged. It was in the risk arbitrage side of the firm that the insider trading scheme occurred.

Steiner was one of the partners in the firm, having been recruited there by Hagerman after serving in a few firms on Wall Street as both analyst and CFO. He served at Hagerman Associates as both CFO and Compliance Officer. His role as compliance officer placed him in a reporting position to the SEC.

The arbitrage unit operated in a small room above the trading floor, and it was there that Steiner discovered the insider trading scheme. Christopher Reuther, a young new trader, was having a tremendous run of success naming companies that were soon to merge or be bought out.

This raised Steiner's suspicions, which were confirmed in a social evening Steiner held at his apartment specifically for the purpose of engaging Reuther in incriminating conversation.

Reuther had only too easily obliged, offering not only his part, but how he received the information (a lawyer friend at a very reputable firm), and the complicity of at least Jason Witter (head of trading at Hagerman Associates), and possibly also that of Adam Hagerman himself.

The (A) portion of the case ends with Steiner at the point of deciding what to do with this information.

(B) Portion. The second portion of the case details events from the moment Steiner decided to blow the whistle to the resulting arrests and convictions. The options facing Steiner are detailed, as is his rationale for choosing to blow the whistle. Steiner hesitates to blow the whistle to the authorities, however, and first enlists aid from a partner at the law firm to stop the leak from that side. Steiner then proceeds to get his own lawyer. After ten days of hesitating, Steiner finally goes to the SEC, while the law firm where the leak was emanating goes to the Manhattan District Attorney.

A number of arrests followed the whistleblowing. Steiner was forced to battle for return of his investment capital. Convictions in the case included both Reuther and Dennis Pfaff, the leak from the law firm. Witter was cleared of all counts, and Hagerman named an unindicted co-conspirator.

### Purpose

This case was written to allow students the opportunity to explore the personal and professional aspects of the decision to blow the whistle, and second, the variables that make whistleblowing more or less effective. The case deals specifically with a financial services firm

and the professional responsibilities of its compliance officer, but the principles can be applied in many professional settings.

After reading the (A) portion, students are expected to be able to formulate and defend a plan of action, one option of which would be to decide to blow the whistle. In the (B) portion of the case, students are expected to be able to critique Steiner's actions from the perspective of effective whistleblowing. Students should explore the issue of professional compliance obligations, particularly when those obligations extend beyond the firm and supersede the rights of the firm.

This case can also be used to illustrate the difficulty applicants encounter when trying to perceive ethical issues at firms they are considering as future employers, particularly when those firms are small and relatively unknown. Students might formulate what sorts of questions they would ask in order to explore professional ethics at firms where they are interviewing for jobs.

#### Learning / Teaching Objectives

- What constitutes the occasion for, and the obligation to, blow the whistle
- The personal cost of blowing the whistle
- Elements that make for more, and less, effective whistleblowing
- Strong vs. weak professional self-regulation systems

#### Teaching Methods

This case is intended for use in a course on business ethics, or social issues in business. This case might also be very appropriate for an upper level course in finance, in provoking discussion of the ethical responsibilities of the finance profession.

The two segments are suitable for either undergraduate or MBA level discussions. Class might begin with a discussion of options students have arrived at after reading the (A) portion,

along with the rationale for each option. Class would continue with reading the second portion, after which a discussion of what actions made Steiner's choice more (or less) effective would ensue. The entire discussion should take place in 60 to 75 minutes.

The (A) and (B) portions of the case are straightforward. In the (A) portion, students are clearly left at a decision point, and must formulate and defend an action plan. In the (B) portion of the case, students read the actions of Steiner and can critique those actions from the perspective of effective whistleblowing. Background materials given to students might include DeGeorge's principles of whistleblowing (DeGeorge, 1995), as well as materials on the moral perspectives (both for and against) whistleblowing.

DeGeorge (1995) lists five principles that permit, and then obligate, the individual to blow the whistle on corporate activities. The conditions for permitting whistleblowing are (quoting directly from DeGeorge):

- The firm, through its product or policy, will do serious and considerable harm to the public, whether in the person of the user of its product, an innocent bystander, or the general public.
- Once employees identify a serious threat to the user of a product, they should report it to their immediate supervisor and make their moral concern known. Unless they do so, the act of whistleblowing is not clearly justifiable.
- If one's immediate supervisor does nothing effective about the concern or complaint, the employee should exhaust the internal procedures and possibilities within the firm. This usually will involve taking the matter up the managerial ladder and, if necessary – and possible – to the board of directors.

The conditions for obligating whistleblowing are:

- The whistleblower must have, or have accessible, documented evidence that would convince a reasonable, impartial observer that one's view of the situation is correct, and that the company's product or practice poses a serious and likely danger to the public or to the user of the product.
- The employee must have good reasons to believe that by going public the necessary changes will be brought about. The chance of being successful must be worth the risk one takes and the danger to which one is exposed.

There are two approaches to the discussion. One approach would start with the professional obligations of the compliance officer. The suspicion of insider trading would necessitate blowing the whistle. The question is, to whom: Hagerman or the SEC? This discussion should explore the issue of hearsay vs. evidence, and what constitutes a strong enough case to compel the individual to use external means to blow the whistle.

A second approach would begin by asking the question, if the professional obligation of compliance officer did not exist, would the circumstances as described permit whistleblowing, and if the answer to that is affirmative, do those same circumstances rise to the level of obligating whistleblowing? This discussion will examine the case using all of DeGeorge's principles, noted above.

One issue central to the (A) discussion is how much Hagerman knew of the insider trading activity. Those who believe Hagerman knew will likely vote for external whistleblowing, while those who doubt Hagerman knew will likely believe Steiner was obligated to first tell Hagerman what he knew and only then allowed to externally blow the whistle.

Students may also find the method used by Steiner (surreptitiously taping a cocktail conversation) to be itself unethical. It may be surprising to some that an individual portrayed as

holding values of honesty and integrity would perform in this manner. Discussion might then center on the obligation of the whistleblower to have proof suitable to convince a third party of the malfeasance, and the extent to which that obligation permits an individual to act.

Discussion of the (B) portion of the case should first center on the issue of what constitutes effective whistleblowing (i.e., stopping the malfeasance). While Steiner was effective at stopping the insider trading first by having Pfaff (the source of information) sent out of the country for a week, and then by going to the SEC, the reaction of others on Wall Street indicates that such whistleblowing is perhaps seen more as an annoyance than deterrent. Steiner's actions did stop this instance of insider trading at Hagerman Associates, but there seems to be little long-term effect on others in the financial profession, and perhaps even little long-term effect on Hagerman himself. Discussion could then move to a debate on what constitutes strong vs. weak self-regulation in professions.

#### Questions

(for the (A) portion)

1. What are Steiner's options? Which would you choose? Why?
2. What are the threats to Steiner at this point? How strong are they, in terms of dictating his decision?

(for the (B) portion)

3. Once Steiner decided to blow the whistle, what were (or should have been) his own ethical concerns?
4. Evaluate the effectiveness of Steiner's actions. Did it stop the insider trading? What might he have done differently that would have increased his effectiveness?

5. Were the punishments strong enough in this case? What, besides punishment, makes for effective self-regulation in a professional environment? What hinders self-regulation?

Potential Responses

1. Steiner's four options are indicated at the start of the (B) portion of the case, along with reasons for and against each. Given the obligation of the position of compliance officer, whistleblowing to the SEC was the strongest option. Students may debate the extent of Hagerman's knowledge. Those that think Hagerman knew nothing will assert that Steiner's first obligation was to report the activity to Hagerman, while those that think Hagerman was in on the insider trading will assert Steiner was correct in going to the SEC.

There are reasons to suspect Hagerman knew of the insider trading. The trades could not have been made without his approval, since he was a major partner. Further, some of these trades had been rejected by Hagerman shortly before. There must have been a reason to change his mind. Finally, Reuther made no secrets on the floor that he was receiving information from elsewhere regarding these corporations.

2. There are a number of threats directed at Steiner. If he fails to report his suspicions of insider trading, he could be judged as guilty as those actually doing the insider trading. He could lose his analyst license, thereby ending his career on Wall Street. A second threat is the loss of his stake in the partnership. Much of his personal wealth is tied up in the firm, and this loss would be at least temporarily devastating to him and his family. A third threat is that, if he blows the whistle and it becomes known he was the one that blew the whistle, he could also effectively end his career, given that whistleblowers are often unemployed in their industries.



3. On a personal level, Steiner holds ethical obligations to himself and his family. His actions must maintain his ability to fulfill those obligations. On a professional level, he is obligated to maintain the integrity of the markets. To the extent that his actions threaten the integrity of the markets, he might be seen as acting unethically, even though the overall intent was to expose the insider trading. The issue here is the amount of time Steiner took between the taping and the actual reporting of the violations. He had temporarily stopped the leak, but by delaying, he is also impeding the SEC and the District Attorney in discharge of their duties.
4. Steiner's actions did stop the leak in this instance, in both the short-term and long-term. The trading ceased, and furthermore, the individuals involved at the lower level were removed from the profession. Neither of the two senior individuals (Hagerman and Witter) were convicted, though the firm itself was convicted. Nor, it seems, did others on Wall Street see this in the same light as Steiner. Other traders appeared to view this as the act of a traitor. Whether one act of whistleblowing can have such large effects is certainly debatable. Student responses should indicate the mixed nature of the final verdict in this case, and explore both short-term and long-term effects.  
  
Certainly, if Steiner had been able to implicate either Hagerman or Witter more clearly, this might have increased the long-term effect of his actions. It is not clear at all that any of his actions would be able to change attitudes of those on Wall Street. It is for this reason that whistleblowing is a social option for those witnessing individual or corporate wrongdoing.
5. For those directly involved in the case, the punishments removed them from the industry, and for some, imposed jail time. Since it might be very difficult to show who was

adversely affected (who lost money because of the insider trades), this level of punishment might be as much as could be expected for these individuals. Likewise, the firm was fined for its participation in the trades, and again, this might be as much as could be expected under the circumstances.

It is not clear from the case whether these punishments provided a signal to others in the profession. However, due to the persistence of the problem on Wall Street, it seems that these punishments (and others before and since) have done little to deter insider trading. Students might discuss what more might be done. For instance, Sam Waksal (Imclone) was sentenced to seven years in prison and fined \$4.2 million for his role in an insider trading scheme. Waksal was a principal in the firm, whereas in this case both Hagerman and Witter (principals at Hagerman Associates) were not convicted. Students might find a difference between the conviction of lower individuals and principals in the firm.

Waksal's conviction also comes at a time that there is increased scrutiny of firms and senior management officials, and be intended to send a stronger signal. This might infer a "timing effect", when it might be better (or worse) to commit white-collar crime.

Professional self-regulation is strong due to the expert knowledge that resides in industry participants, along with the efficiencies such knowledge brings with it. In terms of this case, stock analysts know what constitutes insider trading, how best to detect it, and the most efficient means to control such behavior in the Wall Street environment.

Professional self-regulation is weak, however, due to the inherent conflict between business needs (i.e., profit maximization) and social expectations. In addition, and in many cases, there is also a hesitancy to punish colleagues for fear of informal banishment or retribution. In this case, the partners had clear motivation to use the leaked

information, since doing so boosted firm profits, though the public expects a fair marketplace (i.e., no insider trading) on Wall Street. The hesitancy to punish is demonstrated in Hagerman's ability to retain his license, despite the number of infractions spanning many years.

#### References

DeGeorge, R. 1995. *Business Ethics* (4<sup>th</sup> Ed.). Englewood Cliffs, NJ: Prentice-Hall.

## Revisiting Doing Business in the Middle East

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### ABSTRACT

This case engages students on a number of issues common to doing business in other countries, specifically in the Middle East. It is intended to be a basis for class discussion rather than to illustrate either effective or ineffective handling of the situation. The case seeks to integrate issues of global business, international management, cross-cultural conflict and negotiation, and diversity. Students are challenged to diagnosis a situation and develop solutions in a team environment under limiting time restraints that could have large consequences on the bottom line of a company.

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Aboard an Offshore Services Contractor's flagship somewhere in the Arabian (Persian) Gulf, the captain and crew of the flagship as well as two other support vessels owned by Offshore Services Contractors (OSC) were busy offloading fuel. It was the middle of the night. While the fuel was actually intended for an offshore drilling rig owned by the government of one of the most Islamic and radical countries in the region, offloading the fuel and selling it to smugglers had been a profitable business venture for them for quite awhile. In fact, over the years, they had successfully offloaded more than 200,000 tons of fuel worth close to \$500,000. The captains of all three ships, along with all of the crew members had received money for either actively taking part in the embezzling scheme or for looking the other way when the offloading of fuel took place. Although they felt that the risk was worth the payoff, the crew knew that they risked being charged with contraband, which if caught and according to Islamic law, custom's regulations and international law, would mean that they would risk loosing all of the assets of Offshore Services Contractor, and even stiffer prison terms under horrible conditions.

As the captain scanned the water watching for the Coast Guard vessels that regularly patrolled the Arabian Gulf waters, he thought about all of the stories he had heard about boats that had been boarded and searched by the various Coast Guards of countries in the Middle East. Stories that included the loss of the cargo, the seizure of the ships and even imprisonment for the captain and crew. He knew that getting fired by OSC was the least of his worries. What concerned him even more was that if he and his crew members were caught stealing the fuel they risked being punished under the regulations of Sharia, often referred to as Islamic law.

A few hours later, as the lights of the Coast Guard vessels scanned the deck of the OSC vessels, and began the process of seizing both the vessels and the cargo, the captain realized that he and his crew might have just made the biggest mistake of their lives. Although he could not get a signal on his cell phone and thus could not contact the CEO of OSC, he hoped that his boss would hear the news soon and come to the rescue of the crew of the three vessels that were now being seized.

### **Offshore Service Company**

Offshore Service Company (name disguised) is a company that was formed to provide ships to service offshore drilling platforms. OSC was the brainchild of a 59-year-old British national who had been living and working as a civil engineer in the Middle East for the last 25 years. DJ (name disguised), who had worked hard to build both his business and his reputation in the petroleum service industry was now living in Dubai, the economic capital of the United Arab Emirates in the Arabian Gulf. He had formed the company in 1977 when he recognized the growing need of large petroleum companies for expert offshore and marine support services.

With the help of a local partner, DJ created OSC as an integrated service provider of a range of products and services for oil, gas, and petrochemical companies.

Although DJ was now the managing partner of a large, successful company, the company had humble beginnings. He and his partner had started their operation by subleasing three tugboats and three barges to local petroleum companies who wanted short-term commitments to such equipment. Over the years, he has watched his business grow to a fleet of many ships, including five tugboats, seven supply/utility ships, two platforms, two barges, and various support ships, all of which were partially owned by subsidiaries of the company. All of the ships were owned on a lease to purchase agreement, and required full insurance coverage to protect the value of the investment. At the time of the smuggling incident, OSC employed over 340 staff and crew members from 19 different countries. As the company had grown, DJ had expanded OSC's customer service territory past the traditional geographic boundaries of the United Arab Emirates (UAE). The United Arab Emirates are a federation of seven emirates or states. The main religion in the region is Islam and Muslims make up 96% (Shi'a 16%) and Christians, Hindus and others 4%. Although the emirates are predominately Muslim, they uphold Sharia (Islamic law) to different degrees in their courts. For instance, in Dubai, the legal system is based on the Sharia (Islamic law), but it incorporates elements of Western legal systems in such areas as commercial law.

One expansion outside of the United Arab Emirates occurred when DJ decided to do business with the government-owned oil company (referred to as GOOC) in one of the Islamic and radical countries of the region. Although he realized that a commercial undertaking in this country might be risky, he carefully weighed the risks and decided to initiate service offerings with GOOC. At the time of the smuggling incident, he had contracts with this oil company that

were valued at over \$17 million and included the use of five vessels over the span of five years. Three of those vessels were now in the hands of the government of the country that was home to GOOC.

### **A Brief Overview of Sharia**

Sharia denotes an Islamic way of life that according to Muslims, has been derived from Islam. To Muslims, it represents the religious code for living in the same way that the Bible offers a moral system of conduct for Christians. Sharia has been adopted by many Muslims as a matter of personal conscience and in many Middle Eastern countries is enforced by the courts. While the courts in some countries have adopted all of the elements that make up Sharia, others enforce limited elements such as inheritance, banking, and contract law.

Calling Sharia 'law' can be misleading, as Sharia extends beyond law. Sharia is the totality of religious, political, social, domestic and private life. Sharia is primarily meant for all Muslims, but in some countries, it is applied to non-Muslims living in a Muslim society. The regulations of the Sharia can be divided into two groups, 1) regulations on worship and ritual duties, and 2) regulations of juridical and political nature.

With respect to the judicial and political impact of Sharia, individuals accused of a crime are not presumed to be innocent as they are in the United States. Consequently, it is customary that when a person is considered a suspect in a crime or litigation they are jailed regardless of the evidence, and then questioned about their involvement. The governments in many Muslim countries have been accused by the Western media of convicting people to reinforce governmental power and control public opinion, regardless of the truth or fairness to all parties. Furthermore, the leadership in some Muslim countries has been accused of supporting and

harboring international terrorism, making normal economic exchanges and cooperation difficult. Therefore, economic relationships with the West have been limited by trade restrictions on both economic and cultural levels.

In this case Sharia might have a strong impact on how the government treats the men and on the punishment that might be meted out to them. In this particular country, the legal system was based on Sharia and was interpreted according to the strict Hanabali rite. The principles of government are stated to be justice, equality, and consultation, in accordance with Sharia. Punishments for serious crimes include amputation and death by beheading, hanging, or, in rare cases, stoning (Encarta.com, 2003).

The government might also have a claim on the 10% performance bond taken out by OSC. GOOC and thus the government might claim negligence on the part of OSC, and therefore be entitled to the money secured under the performance bond. The government might also make the argument that they were entitled to the vessels they had seized. DJ is pondering how this might affect his negotiation with the company and the customs officials upon his arrival.

### **Existing Relationship Between OSC and GOOC**

The oil industry plays a vital role in the economic well-being of many countries in the Middle East. Oil is a source of energy and revenue, but requires constant investment, updating, and maintenance. Given the choices made by the country that DJ is doing business with, they have not had the benefit of international economic and technical cooperation that other countries in the Middle East have enjoyed. Due to this country's poor relationship with the West, opportunities to find and enlist expert services to maintain the current industry infrastructure are limited or non-existent because most large multi-national corporations share the views of western



states. Due to GOOC's involvement with the government, it is next to impossible to contract with western companies. However, an Arab-based company with oil service expertise, such as OCS, would be the perfect fit.

In June, 1999, DJ signed a five year service contract with GOOC. The contract stipulated that OCS would provide the expertise and equipment necessary to maintain and update nine oil fields, which included five ships necessary to provide the services. Of the five ships, three were responsible for monitoring the offshore oil fields, supplying the platforms with food and fuel, and transporting personnel and equipment as needed. The supplying of fuel necessary to operate GOOC's platforms and offshore bases was done according to a set schedule. OCS was currently three and one half years into the contract with one and a half years to go. At the time of the smuggling incident, OSC had received \$6.5 million for services rendered, and was owed another \$1.5 million in outstanding invoices. Under contract stipulations, and as was customary in the oil production business, OCS was required to obtain performance bonds totaling 10 percent of the total contract value (over \$1 million in this case). That money could be used by GOOC in the event OCS was negligent in its duties. Also as customary in the industry, all ships were insured for replacement value.

In addition, at the time of the incident DJ and a partnering company were negotiating with GOOC the possibility of additional contracts to include various projects worth \$60 million for the next six years alone.

### **DJ's Dilemma**

When DJ landed in the capital city, he was met by his local representative, Amed, who is a native of the country. A car was waiting to take DJ to meet with the lawyers of OCS who are

working the case. In an hour they would be heading to GOOC's corporate headquarters where they were to meet with the GOOC's operations director who is furious over the situation. The operations director had already indicated to Amed that not only did he want to keep the seized ships; he was considering refusing to pay the outstanding invoices and might call upon customs' officials to jail DJ and Amed too.

DJ understood that this matter would not boil down to just replacing the fuel and paying a fine. He knew that under international law, illegal activity involving contraband automatically grants the government the right to seize all the assets involved, regardless of ownership. Due to the contraband activity, the ships had automatically become the property of the government. As DJ began to realize the financial impact –(estimated replacement value for the ships was \$8.5 million according to insurance policies and \$1.5 million in outstanding invoices) his blood pressure rose.

Ahmed confirmed to DJ that the crews have been treated well and have been provided legal representation through OSC's lawyers. However, what appeared to complicate the matter was that a third party involved in the scheme. The party that convinced the crews to participate in the operation in the first place was the project maintenance manager for GOOC's operations. In short, one of GOOC's own employees was the ringleader and responsible for initiating the pilfering of the fuel . GOOC's operations director appeared to have been caught off guard as customs officials informed him of the allegations after the ships were seized, and he was being pressured to put the blame on OCS in order to avoid embarrassing GOOC and the government.

### **What Should DJ Do?**

DJ was unsure of how to proceed. He was concerned for his crew and his equipment, worried about the future of the contract, and wondered if he would be able to leave the country at all. He realized that he needed to defuse the situation and that his company was at stake.

DJ had a number of things to consider. First and foremost, he needed to figure out how to protect his crew and get them out of jail as soon as possible. He wanted to insure their safety and he wanted to regain ownership of his vessels. He also wanted to be sure that he could continue to do business with GOOC. For planned negotiations, like contract negotiations, DJ always spent a great deal of time preparing for the negotiation meetings. In this case, DJ had very little time to prepare. If you were asked to help DJ prepare for his meeting, how would you answer the following questions?

- 1) What additional concerns arise in cross-cultural/international negotiations that may not be considerations in domestic negotiations?**
- 2) What influence might cultural differences play in terms of communication during the negotiation process?**
- 3) DJ will be negotiating in the capital city of the Islamic country. What impact might this have on the negotiation process?**
- 4) What issues and/or strategies of cross-cultural negotiation should DJ keep in mind during the negotiations?**
- 5) What recommendations would you make to DJ and why?**

# REVISITING DOING BUSINESS IN THE MIDDLE EAST

## TEACHING NOTES

### **Abstract**

This case engages students on a number of issues common to doing business in other countries, specifically in the Middle East. It is intended to be a basis for class discussion rather than to illustrate either effective or ineffective handling of the situation. The case seeks to integrate issues of global business, international management, cross-cultural conflict and negotiation, and diversity. Students are challenged to diagnosis a situation and develop solutions in a team environment under limiting time restraints that could have large consequences on the bottom line of a company.

### **Case Overview**

In this case, DJ, the CEO of Offshore Service Company (OSC) is headed to the capital city of one of the most Islamic countries in the Middle East. He has just been notified that the captain and crew of three of his offshore maintenance vessels on lease to the government-owned oil company (GOOC) of that country have been seized for oil smuggling. They were caught red handed offloading the fuel in the middle of the night in the Arabian (Persian) Gulf. The captains and crews of these ships have confessed to offloading over 200,000 tons of fuel bound for the offshore oilrigs owned by GOOC. The value of the fuel that has been offloaded over the past years is close to one half million dollars. The confessions revealed that all crew members, current and transferred ones, received some money for either actively taking part in the scheme or looking the other way when the offloading of fuel took place. Consequently they are all guilty of contraband. According to customs' regulation and international law, all assets involved in the

contraband were seized. The captain and crew are also in danger of severe punishment under Sharia (Islamic law). This punishment may include fines, imprisonment, mutilation (i.e. the cutting off of their hands) and even death.

After arriving in the capital city, DJ is informed by his local representative, Amed, that although his captain and crew are being treated well, they are still in jail, and that the operations director of GOOC is furious. To make matters worse, the “ringleader” in the smuggling scheme has been identified as a high-ranking employee of GOOC. Although the operations director of GOOC is aware of his, he is being pressured to transfer the blame to OSC. He has also been advised that the government has the right to keep the vessels and cargo they have seized and that the government may not be willing to let GOOC contract with OSC in the future.

### **Research Methodology**

Field interviews were conducted to gather the facts of the case. The names of the organizations, individuals, locations, and/or at times financial information have been disguised to preserve the organizations’ and individuals’ desire for anonymity.

### **Teaching Objectives**

This case touches on a number of issues common to doing business in other countries. It can be used to support discussions relating to global business, international management, cross-cultural conflict and negotiation, and diversity. The case is intended for undergraduate courses that cover the above topics.

The main problem which students should be able to identify in this case is the difficulty of negotiating across cultures when the rules and laws of the two countries differ. When we negotiate within our own culture, it is possible to operate effectively at the intuitive or unconscious level. When we leave our familiar cultural context and enter into international negotiations, the scene changes dramatically. There are no shared values, goals, ethical principles, or cultural assumptions between the negotiating parties.

One approach to teaching this case is to focus on the general issues surrounding doing business in other countries. A second approach would be to focus on cross-cultural or international negotiations.

The teaching objectives would be:

1. To explore the issues surrounding doing business in other countries.
2. To help students understand that the customs and even the laws of Western countries may not apply in Middle Eastern countries.
3. To discuss the differences in handling issues between various countries with vastly dissimilar cultures.
4. To illustrate the process of international negotiation.

The general approach to this case would be class discussion. This discussion could be enhanced by different research assignments given prior to discussing the case. For instance, students or student groups could be asked to research Sharia or Islamic law, or other general issues of culture in the Middle East.

One of the best ways for students to gain an understanding of the multiple perspectives that must be taken into account in decisions made in international negotiations, is through experiential learning and role playing. Students can gain insight into the points of view by taking

part in role play/discussion as stakeholders in the decision. The perspectives that would most likely be represented in this situation would be the viewpoints of OSC and DJ versus the viewpoints of GOOC and the predominantly Islamic government. A natural role for the instructor would be that of a mediator.

The cultural difference issues should be woven into the discussion of the questions posed to students at the end of the case.

### **International Negotiations**

Negotiation is defined by Moran and Stripp (1991, p. 71) as "...two or more parties, who have both common and conflicting interests, who interact with one another for the purpose of reaching a mutually beneficial agreement." This process should not be one of beating one's opponent into submission, but one in which persuasion is used to find a solution in which all parties feel as though they have benefited. This is often termed a win/win negotiation. The negotiators need to do their homework, project the right image of themselves and their company, ask relevant questions, and offer and request appropriate types of concessions at the right time. Negotiating within one's own culture is difficult, but negotiating across cultures is phenomenally more difficult.

### **QUESTIONS**

- 1) What additional concerns arise in cross-cultural/international negotiations that may not be considerations in domestic negotiations?**

Negotiation is a difficult process that requires intelligence, preparation, creativity, flexibility and problem solving skills. In typical negotiations (refer to Lewicki et al, 2001, and Kennedy, 1998 for further details about the stages of negotiation), individuals or organizations

follow prescribed stages of negotiation. Stage one requires preparing for the negotiation including gathering information, identifying the goals of your negotiation, building a rapport before you engage in any negotiations, and more importantly know when to walk out of the negotiation. The next stage, stage two, involved debating the point of negotiation. Stage three involved proposing solutions, including bargaining, with the goal of moving both parties from ideal positions to an agreeable outcome that is accepted by all parties. In stage four, an agreement is reached and the deal is closed. The last stage involves implementing the deal in the form of a formal agreement or actions by some or all parties involved as stipulated in the negotiated agreement.

When negotiating in the international arena, the negotiators face an additional set of problems/obstacles not ordinarily encountered by domestic negotiators. First, the negotiation process will be influenced or colored by the national culture of each of the negotiators. Culture, which involves everything that a people have, think, and do. Edgar Schein (1985, p. 9) defines culture as:

A pattern of basic assumptions – invented, discovered, or developed by a given group as it learns to cope with the problems of external adaptation and internal integration – that has worked well enough to be considered valid and, therefore to be taught to new members as the correct way to perceive, think, and feel in relation to those problems.

Second, international negotiation often entails working within the restraints of two different, and sometimes conflicting legal structures. In this case, the country was governed by Sharia which is often referred to as Islamic law and DJ, as a foreign national, was used to a democratic government system. Additionally, GOOC, who had negotiated the original contract with OSC, was a government bureaucracy and would be expected to exert great authority on the court system.



Finally, negotiation in the Middle East, a region of the world that has had sometimes volatile, or at least unpredictable, geopolitical realities is exponentially difficult. Sudden changes in governments, the enactment of new legislation, and even the eruption of war may temporarily or even permanently end the negotiation process. For instance, Iraq's invasion of Kuwait had far-reaching implications for Western businesspersons who were in the process of negotiating business deals in those parts of the world.

**2) What influence might cultural differences play in terms of communication during the negotiation process?**

The greater the cultural differences, the more likely the barriers to communication. When two people communicate, they rarely talk about precisely the same subject, for effective meaning is flavored by each person's own cognitive world and cultural conditioning.

Western negotiators are often very formal and polite and place great importance on proper protocol and etiquette. One of their main concerns is to get the details right and use all possible means to achieve clarity in their understandings. Western negotiators are often bound by law and not by relationships, tradition, religion and culture.

On the other hand, in the Arab world, a person's word may be more binding than many written agreements and insistence on a contract may actually be insulting. Arabs tend to speak more loudly than Westerners and they may be perceived as shouting during negotiations. It is common for negotiations in business or government offices in the Arab world to be interrupted frequently by telephone calls, secretaries wanting signatures, and even visitors seeking an important word with the person. While Western executives would interpret these interruptions as a sign of discourtesy or lack of interest, the Arabs feels that it would be even more rude to refuse a telephone call or visit from an associate (Hendon, Hendon, and Herbig, 1996).

**3) DJ will be negotiating in the capital city of the Islamic country. What impact might this have on the negotiation process?**

A business negotiator who is negotiating abroad may encounter a number of difficulties. First, he/she will be negotiating in an unfamiliar environment. This involves getting used to differences in language, foods, pace of life, and other aspects of the culture. Even simple tasks like making a telephone call, sending and receiving faxes or simply locating a restroom may be time-consuming tasks.

A negotiator who must travel is susceptible to jet lag and may not be as rested or alert as his/her counterpart. The traveling negotiator will have little or no control over the setting in which the discussions will take place. Factors such as the size of the conference room, the seating arrangement, the length of the negotiations, and even the scheduling of social events can make the process more difficult for the traveler. In this case, DJ will also be separated from his business organization and support personnel.

**4) What issues and/or strategies of cross-cultural negotiation should DJ keep in mind during the negotiations?**

First and foremost, DJ must insure the safety of his captain and crew. If this negotiation process is to be successful, DJ must conduct the negotiations in a manner that will help both sides meet their objectives and emerge as winners. He must keep in mind his goal of a long-term relationship with GOOC. He must also be aware of both his own position and the positions of the customs officials and the officers of GOOC.

DJ must focus on the interests that may lie behind the positions taken by GOOC and the customs officials. The operations director for GOOC has made his position clear to Amed. He

plans to keep the vessels and cargo, he is considering jail terms and/or fines for the captain and crew, and he is considering canceling the current and future contracts with OSC. DJ needs to look beyond the position to the basic needs that gave rise to those positions in the first place. The operations director is being pressured by the government to take a stand against OSC, but he is also embarrassed and may be facing punishment for not knowing about the involvement of one of his own employees. The government and court system has a responsibility to uphold the tenants of Sharia, but they must also be cautious of the bad press that they might receive in the International media if they apply these tenants to the extreme. They have limited opportunities to contract for services with countries who do not support them politically. DJ himself is first concerned for the safety of his crew, but also for the continued relationship and contracts with GOOC.

Finally, DJ must remain flexible and he must be sensitive to the timing of the negotiations. Although from a business standpoint he would like to regain possession of his vessels, he must remember that a situation as complex as this may take weeks, months, or even years to resolve.

**5) What recommendations would you make to DJ and why?**

There is no right set of recommendations. This question should provide the basis for class discussion and the opportunity for students to realize that their recommendations may also be culturally based. Most students from Western countries will argue that GOOC is just as guilty as OSC if guilt is to be assigned and should therefore give back the vessels and release the captain and crew. Students from Middle Eastern countries that adhere to Sharia will mostly likely argue that the captain and crew are guilty of stealing and thus punishable by law. They may also argue

that the government has the right to keep the ships. This type of discussion provides the instructor with the opportunity to point out that acceptance of other cultures may go beyond accepting the fact that religious holidays may be different in different cultures or that people from different countries speak with different accents.

## **EPILOGUE**

DJ had the meeting with the director of operations who had calmed down a great deal as he realized that DJ was not part of the scheme. The crew was subsequently expelled from the country with the warning to never reenter the country. They were told that if they did so, they would face jail time. The ships were released from customs' custody. New crew members were flown in as replacements to regain possession of the ships, and continue the work detailed in the contract.

All of this was accomplished over an eight month period which allowed GOOC to save face in the Western and local media in terms of country leadership. OCS and GOOC agreed on a fine and on a schedule to repay the face value of the lost fuel. DJ negotiated with his bond/insurance company to share the cost of the fine and fuel payment instead of submitting a claim under the performance bond.

Currently, DJ benefits from an excellent relationship with GOOC and the government of their home country where he has subsequently bid and has been awarded portions of over \$60 million in service contracts.

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## Segway: A New Dimension in Human Transportation

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### ABSTRACT

The Segway Human Transporter (HT) is a self-balancing, personal transportation device. The product was invented, owned and originally distributed by Dean Kamen, a famous creator of revolutionary products such as the IBOT™ Mobility System and the first portable insulin pump. The Segway HT was released in December 2001, but two years later the majority of potential consumers were still unaware of its existence. In early 2004, the Segway HT's only customer base – early adopters – was too small to let the product realize its desired profitability.

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In December of 2001, Dean Kamen unveiled his self-proclaimed revolutionary product – the Segway Human Transporter. There was a tremendous amount of speculation surrounding the unveiling of the product. News of a revolutionary new product invented by Kamen, had leaked. Several newspapers, technology authors and science enthusiasts speculated on what the product would be – the product was named Ginger and IT by the media. However, in Silicon Valley, Kamen revealed the Segway to “officials from San Francisco International Airport, the California department of transportation, the city of Palo Alto, Stanford University and John Chambers of Cisco Systems John Chambers<sup>120</sup>”. On December 2, 2001, Kamen went national with his debut on Good Morning America.

Segway is “a self-balancing, personal transportation device designed to go anywhere people do<sup>121</sup>”. The company’s Chairman, Kamen, created Segway’s technology and design; this is not the first invention for Kamen. However, this is the first product that he and his corporation Segway HT, are producing, manufacturing and marketing without the help of outsiders from the

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<sup>120</sup> *Reinventing the Wheel* by John Heilmann from Time Online Edition December 2, 2001.

<sup>121</sup> From Segway’s website, [www.segway.com](http://www.segway.com)

company itself. Kamen invented the Segway with the idea of having the device eventually replace our modern day cars. Segway is battery operated, has no engine, no brakes, no throttle, no gearshift, and no steering wheel, and can run all day, non-stop on five cents worth of electricity<sup>122</sup>.

Kamen has been very successful with his previous revolutionary inventions. Kamen's inventions include the IBOT (which his where the technology for the Segway was created), the first portable insulin pump, the first portable dialysis machine, and heart stents (one type is currently implanted in Vice President Dick Cheney's heart). However, the question arises – can Kamen maintain his successfulness with the Segway as the manufacturer, distributor and marketer? Will the product revolutionize modern day transportation? Can the inventor of a product successfully take a significant role in successfully marketing their product?

### **Dean Kamen**

Dean Kamen was born in 1951 on Long Island, New York, and son of the 1950's famous comic book artist Jack Kamen. Today lives near Manchester, New Hampshire in a hexagonally shaped, 32,000 square-foot home he designed. The grounds include a baseball diamond, his Hummer, Porsche and two helicopters (“both of which he helped design and one of which he uses to commute to work each day<sup>123</sup>”). Kamen also owns a small island off the coast of Connecticut, which he calls “North Dumpling,” and considers it to be “a sovereign state.” It has its own flag, navy, currency (all of which he, of course, created), and “mutual non aggression pact” with the U.S. signed by Kamen and President George Bush<sup>124</sup>.

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<sup>122</sup> From Segway's website, [www.segway.com](http://www.segway.com)

<sup>123</sup> *Reinventing the Wheel* by John Heilmann from [Time Online Edition](#) December 2, 2001.

<sup>124</sup> *Reinventing the Wheel* by John Heilmann from [Time Online Edition](#) December 2, 2001.

His career started when he was attending Worcester Polytechnic Institute with his brother who was a medical student at the time. When his brother told him how difficult it was to administer intravenous drugs to cancer patients and diabetics, Kamen's imagination was sparked; and this prompted him to invent the first portable infusion pump (which enables patients to receive their medication without having to stay in a hospital) while he was still in his twenties. This was just the beginning of his career as a physicist and mechanical engineer. Kamen never graduated from Worcester Polytechnic Institute. He is a self-taught inventor, with several honorary doctorates, and a self-made millionaire.

Dean Kamen holds more than 150 U.S. and foreign patents related to medical devices, climate control systems, and helicopter design. He also developed a company called DEKA Research and Development. This company was "founded in 1982 by Dean Kamen, consisted of a relatively small group of individuals and lots of innovative ideas. Today, almost 200 engineers, technicians, and machinists work in our electronics and software engineering labs, machine shop, and on CAD stations... DEKA's mission, first and foremost, is to foster innovation. It is a company where the questioning of conventional thinking is encouraged and practiced by everyone—engineers and non-engineers alike—because open minds are more likely to arrive at workable solutions. This has been our formula for success since we began, and it will continue to drive our success in the future."<sup>125</sup> Kamen also founded FIRST – which stands for: For Inspiration and Recognition of Science and Technology, ten years ago. FIRST's purpose is to "inspire young people, their schools and communities an appreciation of science and technology, and of how mastering these can enrich the lives of all"<sup>126</sup>. FIRST's mission is to "designs accessible, innovative programs to build self-confidence, knowledge and life skills while

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<sup>125</sup> [http://www.thefutureschannel.com/kamen\\_conversation.htm](http://www.thefutureschannel.com/kamen_conversation.htm)

<sup>126</sup> [http://www.usfirst.org/about/bio\\_dean.htm](http://www.usfirst.org/about/bio_dean.htm)



motivating young people to pursue opportunities in science, technology and engineering.”

Kamen has been honored with several awards, some of which include<sup>127</sup>:

- The Juvenile Diabetes Research Foundation - New England Chapter, New Hampshire Branch, named Dean Kamen “2002 Person of the Year”.
- President Clinton awarded the National Medal of Technology to Kamen in 2000, for inventions that have advanced medical care worldwide, and for innovative and imaginative leadership in awakening America to the excitement of science and technology.
- The Heinz Award was given to Kamen in 1998 in Technology, the Economy and Employment for a set of inventions that have advanced medical care worldwide.
- In 1994 Kamen received the Kilby Award, which celebrates those who make extraordinary contributions to society through science, technology, innovation, invention and education.

In 2001 Kamen released to the media and business consumers, his Segway invention. As explained by Kamen to TIME in 2002, “the big idea is to put a human being into a system where the machine acts as an extension of your body.”

### **How It Works**

A Segway is made up of eight critical parts, which enable it to work. The eight parts are: balance sensors, motors, batteries, control shaft, “sister boards”, tires, rubber diaphragms, and chassis. The balance sensors contains the five gyroscopes and tilt sensors that work together to determine shifts in body weight and changes in terrain. “A basic gyroscope is a spinning wheel

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<sup>127</sup> [http://www.usfirst.org/about/bio\\_dean.htm](http://www.usfirst.org/about/bio_dean.htm)

inside a stable frame...because of its resistance to outside force, a gyroscope wheel will maintain its position in space (relative to the ground), even if you tilt it.<sup>128</sup>” Segways use a solid-state angular rate sensor constructed made of silicon. This sort of gyroscope determines an object's rotation using the apparent turning of an object in relation to another rotating object on a very small scale. Although the Segway has five gyroscopic sensors, it only needs three to detect forward and backward “pitch” or tilt away from a vertical position, as well as leaning to the left or right (termed "roll"). The extra sensors are there to make the vehicle more reliable. The balance sensors are two “tilt sensors filled with electrolyte fluid. Like your inner ear, this system figures out its own position relative to the ground based on the tilt of the fluid surface.”

There are two motors that work independently to drive each wheel. The motors are completely emission free and are able to transfer power even if one fails. There are two types of batteries available for the Segway, NiCd and the NiMH. The control shaft is height adjustable and is made of die cast aluminum.

There are two “sister boards” or circuit boards that send the commands to the motors based on input from sensors. If one of the boards fails, the other can completely function alone. The Segway’s “sister boards” are extremely important because they need to make extremely precise adjustments to keep it from falling over. In normal operation, these boards check the position sensors about 100 times per second. There are two tubeless tires attached to the Segway. They are resistant to flats, and treated for enhanced traction on wet surfaces, and to leave no marks indoors. The rubber diaphragms are located under the rider platform and are what engages the machine in its self-balancing system. The chassis houses the electronic components of the Segway and has been tested to withstand seven tons of force.

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<sup>128</sup> How Stuff Works, *How Segways Work* by Tom Harris.

## **Products**

Segway HT has three main product lines the e, i and the p series. First is the e series, which is only available to business and commercial users. The e series holds up to 75 pounds (additional to the weight of the rider) for storage. It contains three storage cases and has an electronic parking stand so the Segway can balance alone. The maximum speed is 12.5 miles per hour. The total weight of the e series is 95 pounds without cargo. The machine has three keys that determine the maximum speed a rider can drive. The beginner key is black and has a maximum speed of 6 mph, with a slower turning rate. Then there is the “sidewalk operation key” which is yellow, with a maximum speed of 8 mph, and a medium turning rate. The final key is the “open environment key” which is red, and has a maximum speed of 12.5 mph, with the most responsive turning rate. A single battery charge can last from a 5 to 15 mile range of use. The distance is based on the terrain on which the rider travels (i.e. smoother flat terrain, the battery charge will carry a further distance). The e Series has two 60 cell NiMH battery packs, and can be recharged by a 90 to 260 volt and 50 to 60 Hz AC outlets. A complete cycle charge will take four to six hours, at a cost of less than 10 cents of electricity. The model also has a redundant balancing and electrical system. This is to ensure the safety of the rider in case the first system fails. “If any system begins operating at diminished capacity, the other is programmed to assume responsibility while maintaining balance and bringing the Segway HT to a safe stop.”<sup>129</sup>,

The e series is not available to the general public – it is only available to businesses. The way, in which a business would purchase the product, is to get in touch with the Segway Company directly for the purchase. The cost is \$5,500. Some companies and governments use the Segway e series today. They include: the City of Seattle, the United States Postal Service,

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<sup>129</sup> How Stuff Works, *How Segways Work* by Tom Harris, and <http://www.Segway.com>

Michelin of North America, GE Plastics, Delphi, City of Atlanta, Georgia Power, and the Boston Police Department.

The i series is the second Segway model which is intended for consumers (but is also available to businesses as well). The i series costs \$4,495 to purchase (the price of the i was reduced by \$500, when the p series was released). The i series has been available for pre-order since November 2002, and shipments were received in March 2003. Any of the specifications are the same as the e series; however, the i series does not come with storage space, weights 83 pounds, and has a riding capacity of 250 lbs. All Segway's come with "power assist mode." "Power assist mode was designed to help you maneuver the Segway HT when you are not on the machine. In this mode, the Segway HT's motors are used to assist the user in moving the unit forward or backward. This motion is controlled by the steering grip, which becomes a speed control when in power assist mode. This allows you to ascend or descend stairs more easily and better navigate challenging terrain."<sup>130</sup>,

The newest product that Segway released is the Segway p series model, which costs \$3995. The p series was released in October 2003, for pre-ordering, and became available for shipment in mid-November 2003. The p series is the smallest and lightest weight Segway available. It weights 70 pounds (13 lbs lighter than the commercial i series), and has a shorter riding range than the e or i (the p series range is 6-10 v. 8-12). The temperature in which a rider can use the p series is also different from the other two products. The e and the i series can both be used in temperatures ranging from 32-122 degrees Fahrenheit. However, the p series can be used in 40-122 degrees Fahrenheit. The platform and footprint of the i is also smaller, it is a 6.7 in platform height (versus 8.3) and the footprint of the p is 16x21.8 inches (versus 19x25 inches).

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<sup>130</sup> [www.segway.com](http://www.segway.com)

Finally, the battery requirement for the p model is also smaller. The p requires two 48 cell NiMH batteries, compared with the two 60 cell's need for the other two models.

### **Purchasing A Segway: Distribution Channels**

When Segway was first announced in December 2001, the product was only available to commercial consumers. In November of 2002, the product was available for “pre-order” for consumers through Amazon, or through Segway directly. The customers received their Segway (at the time the i series was the only consumer product available) in the last week in February through March 2002. There was only one promotional exception – on December 25<sup>th</sup> 2002, thirty Amazon winners received a Segway two and a half to three months before other consumers. However, with the exception of those thirty winners, the rest of the consumer market had to wait just a bit longer. The year between the announcement and release of the product was because the company was further testing the safety and reliability of the product and trying to create legislation that would allow Segway’s use. The ways to purchase a Segway vary depending on the model desired. Purchasing an e series can only be done through Segway itself. However, purchasing the i or p series, consumers are faced four options. They may contact Segway directly, go to an authorized dealer, order through Amazon.com, or through Brookstone.

Consumers may contact the Segway Company itself by calling 1-866-4SEGWAY. The facility is open from 8am to 5pm Eastern Standard Time for orders, and till 8pm for technical support issues. This facility is located in Segway’s manufacturing plant in Bedford, New Hampshire.

There are 10 “authorized” dealers of the Segway throughout the United States. Through an authorized dealer, the consumer may purchase and or rent a Segway. Authorized dealers are located in: Anchorage (Alaska), San Diego (California), Wainscott (New York), Batavia (Ohio), Houston (Texas), Salt Lake City (Utah), Fond du Lac (Wisconsin) and Margate, Celebration, and Key Biscayne (Florida). Anchorage, San Diego, Salt Lake City Fond du Lac and all three Florida locations also allow Segway rentals; there only one authorized rental facility (they do not sell Segways for purchase) in Waikiki, Hawaii.

The other options for the p and i series is through Amazon.com, or Brookstone stores. Amazon was the first outside organization to carry Segways. Up until the middle of 2003, Amazon and Segway were the only two ways to purchase Segways. However, in the fall of 2003, Brookstone stores decided to offer customers the opportunity to purchase the product. The negotiations between Segway and Brookstone were a long time in the making. Brookstone, although known for their technologically advanced products, did not want to carry Segway’s because of the extremely high carrying costs associated with the product. Together, Segway and Brookstone came to an agreement that Segway’s would only be available to “test drive” in certain Brookstone locations. Also, Brookstone would not carry any Segway’s in their inventory. A customer can purchase the Segway through Brookstone’s 1-866 number, or a Brookstone associate can make the phone call for the customer.

When a customer purchases a Segway the price includes an orientation with a first ride (if desired), and a limited warranty. Product orientation is included for one person, no matter where you purchase your Segway (authorized dealer v. Brookstone v. Amazon v. Segway itself). Orientation is not a requirement to purchase the product, but is a free and teaches new owners

how to maneuver their product, and use all of its features. Usually orientation is scheduled through a Segway representative, five days after the consumer receives their product. Products are available for returns only if the Segway is not used within 10 days of receiving their purchase. Segways must be in their original packaging, and the consumer is responsible for return shipping costs, and a 10% (of total purchase price) restocking fee. All Segway when shipped are shipped through BAX, a freight carrier. Shipping costs are \$100 for standard shipping (5-10 business days), and \$250 for expedited shipping (3 business days).

### **Management & Organizational Structure**

The inventor of the product Dean Kamen helped to manage Segway HT. He was the founder and has been chairman since Segway launched. Segway has had three presidents during the first two years<sup>131</sup>. A former Chrysler executive was the first, and George Muller (formerly a Subaru executive) was the second. Both apparently were a bad fit for the small startup company. Vernon Loucks Jr. was brought in in January 2003 as the new CEO. He is the retired CEO of Baxter International. In November of 2003, Ron Bills replaced Loucks as CEO. Bills was a board member who just received the title of CEO. Bills is a former general manager of Polaris Marine division. Polaris Industries, Inc., is a leader in the snowmobile industry, manufacturers' personal watercrafts, and is one of the largest manufacturers of all terrain vehicles in the world. The Segway Company has no stated vision or organization goals that are available to the public. Also, Segway states that the organization has no mission statement – at all.

There are several “teams” that make the Segway possible. The teams are: User Interface Design, Power Base Design, Embedded Design, Industrial Design, Dynamic, Mechanical

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<sup>131</sup> Wired Magazine Issue 11.03, *Segway's Breakdown* March 2003 by Gary Rivlin.

Integrity, Electrical Integrity, Supply Chain, Manufacturing, Technical Service, Regulatory, Marketing, Sales, Information Technology, Human Resources and Finance<sup>132</sup>.

The User Interface Design Team designs the interface the Segway uses to make it easy to read. The Power Base Design Team implements Segway's mechanical design and determines all the components to ensure design and performance specifications are met. The Embedded Design Team creates and tests the electronics and software responsible for the functioning and balancing of the Segway. The Industrial Design Teams helped develop the physical characteristics of the Segway. The Dynamics Team wrote the software that the Segway uses to balance and maneuver. The Mechanical Integrity Team is responsible for testing the conditions in which a Segway can withstand. The Electrical Integrity Team tests the electronic components that make up the Segway. The Supply Chain Team researches and created partnerships with current suppliers, and ensure that manufacturing is constantly stocked. Manufacturing actually assembles the Segways, and the Technical Service Team assists customers and the factories that produce the Segways. The Regulatory team works with national and municipal authorities to try to ensure that Segway is viewed as an "extension of the pedestrian."

The Marketing Team is responsible for building the company's identity. "They manage a multi-faceted strategic approach to brand creation, including carrying out an opportunity assessment, developing a marketing vision, and helping to define a new category of human transportation.<sup>133</sup>" Segway's marketing is the liaison with commercial consumers, and also includes the "Web Team," which designs Segways website with the goal of being "scalable and reliable." Most of the marketing is done in-house, however, certain projects are contracted out,

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<sup>132</sup> [http://www.segway.com/aboutus/the\\_people.html](http://www.segway.com/aboutus/the_people.html)

<sup>133</sup> [http://www.segway.com/aboutus/the\\_people.html](http://www.segway.com/aboutus/the_people.html)



and the projects and the name of the marketing group are not disclosed. The Sales Team is responsible for selling the Segways to commercial consumers only. The IT Department of Segway helps to run the website and appropriately channels questions and orders.

*Partners*<sup>134</sup>:

Silicone Sensing Systems (helped to develop and provide gyros and tilts), Michelin (tires are used on the Segway), Pacific Scientific (designed Segway's electric servo motor), Delphi Corporation (helped develop integrated circuit boards), Saft (helped develop the batteries), Magnetek (developed recharge on batteries), Axicon Technologies (supplier of Segway's transmission), GE Plastics (manufactures the SOLLXTM polymer that is used as an alternative to paint on the Segway. SOLLXTM is a weather resistant film), Micro Processor Designs, Appshop, Jager Di Paola Kemp Design.

**Laws/Legislation**

Since the release of Segway i and p series, the Segway organization's Regulatory Department has spent a considerable amount of time and energy lobbying to have their product legally allowed to be operated on sidewalks, bike paths, parks, and roads. There are 40 states within the US, and the District of Columbia have "permissive legislation," which allows Segway to be operated on sidewalks, bike paths, and specific roads. The laws vary from state to state, and local governments are permitted to create additional regulations or rules as to where Segway's can be operated legally. The following 40 states are: Alabama, Alaska, Arizona, California, Delaware, Florida, Georgia, Hawaii, Iowa, Idaho, Illinois, Indiana, Kansas, Maryland, Maine, Michigan, Minnesota, Missouri, Mississippi, Nevada, North Carolina,

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<sup>134</sup> [http://www.segway.com/aboutus/development\\_partnerships.html](http://www.segway.com/aboutus/development_partnerships.html)

Nebraska, New Hampshire, New Jersey, New Mexico, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, Vermont, Washington, Wisconsin, and West Virginia.

States such as Connecticut, Massachusetts, New York, North Dakota, and Wyoming have no enacted legislation that permits Segways in pedestrian areas. This does not however, mean that Segways are prohibited; it simply means there is no official state legislation regarding the use of Segways. Other states, such as Arkansas, Colorado, Kentucky, Louisiana, and Montana have no state prohibitions or restrictions for the use of Segways.

### **Competition**

Kamen has said that his dream for the Segway is for it to replace automobiles – eventually. The automotive industry is a giant industry to conquer, whose function is seen as invaluable to most – especially in the US. The auto industry is also moving toward hybrid cars, which are more environmentally friendly. Hybrids release less carbon dioxide, which in turn creates less air pollution through emissions. Hybrid cars are powered by a combination of gasoline and electric components. The benefits of hybrid cars are less tailpipe emissions and improved mileage. Several automakers currently produce hybrid cars within the US; namely the Honda Insight and the Toyota Prius. Several other manufacturers have already manufactured hybrids and are planning to introduce them to the US market in the up and coming year.

### **The C5**

In 1985, Sir Clive Sinclair released his Sinclair C5. The C5 was “the last futuristic transport.<sup>135</sup>” The C5 was the last public attempt, until the release of the Segway HT, at a suggested solution to moving around cities, and perhaps a replacement of the automobile. It lasted only ten months in the UK before it was scrapped. The C5 was a battery and pedal

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<sup>135</sup> BBC News: UK Edition, August 5, 2003 *Move over Segway, I'm Planning the C6* by Jonathan Duffy.

powered, three-wheeled, vehicle at a cost of 399 British pounds that was significantly smaller and lower than an automobile. The C5 sold 5,000 units, 1,000 of which were sold in the first month, before its dissolution. The main cause of the C5's flop was it was "too extreme for the British public. It received a bad press, being widely condemned as unsafe and impractical"<sup>136</sup>, and "was declared a death trap by the Automobile Association because it was too small to be seen by lorry drivers."<sup>137</sup> The inventor Sir Clive was famous inventor in the 1970's and 80's, and claims to be releasing a C6 sometime in 2004, that would compete with Segway.

### **Strategy's & Goals**

With the creation of Segway, Dean Kamen stated that the goal was "building something that would make a unique and lasting contribution to society."<sup>138</sup> Financing Segway's manufacturing, production, and marketing receives some funding by Credit Suisse, First Boston Private Equity, Kleiner Perkins Caulfield & Byers (investment of a reported \$38 million) and "a number of individual investors." Venture capitalist John Doerr, of Kleiner Perkins Caulfield & Byers, who helped back Segway, predicted it would reach \$1 billion in sales faster than any company in history<sup>139</sup>.

Although Kamen had invented before, he was unwilling to give over the manufacturing capabilities to any other company. Kamen has been quoted as saying "It's a new idea. That's what's so exciting, but that's also why I couldn't license the technology"<sup>140</sup>. He also states "If I had partnered up with somebody, we wouldn't have the thrill, frankly, of helping to add this new

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<sup>136</sup> MENSEA, the *High IQ Society* profile of Sir Clive from <http://www.mensa.org.uk/mensa/clivesinclair.html>

<sup>137</sup> BBC News: UK Edition, August 5, 2003 *Move over Segway, I'm Planning the C6* by Jonathan Duffy.

<sup>138</sup> [www.segway.com/aboutus](http://www.segway.com/aboutus)

<sup>139</sup> *Wired Magazine*, Issue 11.03 March 2003 *Segway's Breakdown* by Gary Rivlin.

<sup>140</sup> Fortune Small Business article entitled Profile of an Entrepreneur on a Roll: Dean Kamen published July 9, 2002 by Brian Dumaine.

dimension of transportation to the world<sup>141</sup>.” This is why Kamen could not give up the licensing of manufacturing, distribution and selling to any other organization – Segway is truly under the control of Kamen and his board members.

Kamen has determined that Segway will change the way society views and uses transportation. He was quoted as saying “I want to make a product that really has a serious impact on the environment that can bring energy back to our inner cities.<sup>142</sup>” He forecasted, “By the end of 2002, his enterprise would be stamping out 10,000 machines a week.” University of Pennsylvania professor Karl Ulrich stated that he estimated by the end of 2002 “they’re producing 10 per week.” The discrepancy in forecasts between those involved with the Segway creation and financing, and those outside of its actual operations, are quite different.

With the millions invested (an estimated \$90 million, with Segway LLC worth estimated at \$650 million<sup>143</sup>) sales not reaching billion dollar marks, Segway could be marked as a complete let down.

### **The Future**

Kamen’s aspirations for the Segway are great – Kamen believes Segway “will be to the car what the car was to the horse and buggy.<sup>144</sup>” For a future so great, there are several options ahead for the company.

First, the organization can progress as it has thus far. The company has made slow progress since its release. However, this progress is consistent with Kamen’s desire to “protect” Segway from being marketed or sold as a toy or recreational product. Kamen has invested and

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<sup>141</sup> Fortune Small Business article entitled Profile of an Entrepreneur on a Roll: Dean Kamen published July 9, 2002 by Brian Dumaine.

<sup>142</sup> Fortune Small Business article entitled *Profile of an Entrepreneur on a Roll: Dean Kamen* published July 9, 2002 by Brian Dumaine.

<sup>143</sup> Wired Magazine Issue 11.03 March 2003 *Segway’s Breakdown* by Gary Rivlin.

<sup>144</sup> *Reinventing the Wheel* by John Heilemann.

financed Segway's manufacturing facility through his own finances and outsiders. Both he, and his financiers, seem confident that the strategy, which they are pursuing, is the best available option.

Or Kamen could sell the rights and manufacturing facility of Segway to an outside manufacturer. Kamen is a seasoned inventor who previously has licensed out all of his other inventions to experienced organizations. This has been the main criticism behind the strategy pursued by Segway. Many have said that Kamen is a genius inventor; however, they criticize his ability to be a part of effectively marketing and producing products. By Kamen selling the licensing of the Segway, he would then relinquish his control over the day-to-day operations of the company. Kamen could buy some ownership in the organization that he sells the rights to, in order to continue his involvement with the Segway product.

Still another option that is Segway can hire an outside marketing firm that could help it to effectively develop a marketing strategy for the Segway products. This would allow Kamen the final say on all matters having to do with the marketing and selling of Segway, while gaining a professional's opinion and guidance on how to develop a demand, and market the product.

The future of Segway is uncertain. Kamen, as the inventor of the product, has taken on a huge responsibility with Segway. Until now Kamen has invented and then licensed out his products to large, established manufacturers to produce and market/sell. However, he will not release the license of the Segway. The question arises whether or not Kamen, as the inventor, is a suitable Chairman of Segway, HT. Also, whether his presence has helped or hindered the product's growth and profitability. Is his product the revolutionary mode of transportation? Is it possible that the product will reach Kamen's forecasts and aspirations?

## SEGWAY TEACHING NOTE

### **Overview:**

This case is intended for the use of corporate strategy courses, marketing strategy courses, promotion courses, or business management courses that discuss corporate strategy. The case is intended to give an overview of the company that will allow students to identify the current issue(s) experienced, the cause of the issue(s), and provoke suggestions on how to best proceed based on both assumptions, corporate strategy theories/models, and opinion, on how the company will strategically proceed for the future.

### **Synopsis**

Segway is a product invented, owned and distributed by Dean Kamen, an infamous inventor of revolutionary products such as the IBOT, and the first portable insulin pump. It has been two years since the release of the product; the majority of consumers are still unaware that it exists. Segway's only customer base (early adopters) is too small to let the product realize the profitability desired. The efforts of the company, lead by Kamen, as the Chairman and Founder, have been timid in their pursuit of turning the Segway into the revolutionary product they claim it is, and would be.

Kamen, with the help of his marketing team, have broken into one new distribution channel one year after the release of the product. Brookstone has been the first national store to take on Segway as a product and distribute it to customers. However, there are still areas that the organization needs to address. These include:

- Marketing strategy
- Growth strategy

- Financial growth and performance
- Importance of consistent and coherent corporate strategy

**Teaching Objectives:**

This case is designed to address the problems in creating a new organization, with a product that caters to a niche market. It provokes thought about how to effectively marketing new products, and establishing a consistent and concise corporate strategy that supports growth and profitability. Several approaches can be used in addressing these issues including management strategies, leadership strategies, advertising strategies, promotional strategies, marketing strategies, organizational structure and effectively reaching target markets.

The Segway Case represents the opportunity for students to diagnose and assess the ineffectiveness/effectiveness the organizations strategy, marketing and distribution channels. At the end of the case, students should recognize that the efforts of the current strategy of the Segway Company have been unsuccessful up to this point. The leadership and organizational direction must first change in order for the company to grow and be profitable.

**Teaching Plans:**

The case highlights the brief history of Segway's organization, from inception to present. The focus of the discussion should be on where the current strategy's pitfalls are, and what improvements need to be made for the future. The two primary issues to be addressed are: how can Segway improve upon its corporate strategy? And, has Kamen's close involvement with the business side of the product helped or hindered its growth? Within the case, specifics are provided to prompt this discussion. Analysis of the current Segway strategy, markets that the

product needs to reach, ideas on how to effectively advertise the product, organizational leadership, and external competitive forces.

### **Assignment Questions & Analysis:**

#### ***1. What are the main issues the Segway Company is facing?***

The organization lacks a consistent strategy, and effective leader in pursuing that strategy. The company has experienced the leadership of four CEO's within the first two years of the organizations creation. Also, Segway needs to find a way to lessen the carrying or inventory costs associated with its product to entice distributors to carry their product. Another issue facing Segway is its ability to increase customer awareness through an effective marketing strategy – especially through advertising and promotion techniques that would create attention and demand for the product. The company's marketing techniques, up to this point, have been minimal and so has their effect. The final strategic issue facing Segway is tight product control over the positioning of the product. Kamen's idea was to have a revolutionary product that is demanded by all consumers, and to not have his product seen as a "high-tech scooter." This overly cautious desire has hurt Segway's growth tremendously, because many are still unaware it exists.

#### ***2. Has Kamen helped or hindered the Segway Company? Why or why not?***

Kamen has hindered the adoption and profitability of Segway more than helping the company become successful. Kamen had spawned a great deal of media attention around himself and the release of his new product. When Kamen unveiled his product, however, the product did not live up to the media's hype.

Then, when the product was finally announced, it was not available to consumers – only to the business consumers. When the product finally became orderable, consumers were again



forced to wait four months before they took delivery. The only available distribution channels, for eleven months, were through Segway website (where consumers were given a phone number to call and order from a representative) or through Amazon.com. This has also hurt Segway because consumers were unable to test the product before purchasing it; also, because Segway has such a high price tag and strict return policies, many consumers who may have been willing to purchase the product turned away.

Kamen wanted the Segway to be perceived as a revolutionary product that would change the way people viewed and used transportation. However, Kamen's fear of having Segway seen as a "scooter," has kept the product from becoming widely known by consumers. The product has remained under his close guard – and this has been what has hurt the products growth.

Finally, because Kamen is independently wealthy and able to sustain Segway as a product with some financial investors who "believe" in the products and their potential – it can be viewed that this too hindered the Segway Company. Because profitability is not the first and foremost concern of the organizations leaders (product image and consumer perception are the main issues), the company is less motivated to turn a profit.

### ***3. What strategy is Segway pursuing? And, how effective is their current strategy?***

Segway is a highly differentiated product that caters to a niche market. The product is held at a premium price, and as of yet, only those who actively looked for such a product found it. However, the goal of the product, as stated by Kamen is to replace automobiles. This however, is not feasible based on the company's current strategy. The product is revolutionary, and one of the first in the alternative transportation areas. However, based on the organizations goal of

having Segway's filling streets, and becoming the US's choice transportation mechanism – the Segway is far from realizing this dream.

The reason for the difference in the company's goal and current situation is the differentiation strategy it's pursuing. In order to have an effective differentiation strategy, a product must be offered at a premium price. However, this price (coupled with ineffective marketing strategies) is what is keeping consumers from adopting Segway's. Therefore, based on the organizations goal of having Segway as a widely known, purchased product the current organizational strategy is not effective.

***4. How can the company improve its current strategy? What do you believe will happen if the company does not change its strategy?***

Improvements on Segway's strategy should include, heavy investments in marketing techniques, specific, measurable, attainable, realistic, and timely organizational goals. Segway also needs better business leadership, rather than Kamen's almost romantic leadership where he takes personal responsibility for all aspects of the product.

If the company does not change its current strategy students should assume that Segway's growth would remain static. The company is making some strides under its new CEO, however for the organization to realize substantial growth and profits its current strategy is not consistent with the organizations goals.

**Epilogue**

In July of 2002 Segway announced, at the Farnborough Airshow, that BAE SYSTEMS and Segway would form a partnership. BAE SYSTEMS would market Segway to the aerospace and defense industry in the United Kingdom. BAE SYSTEMS is “a systems company innovating

for a safer world.” The company operates internationally and designs and manufactures military aircraft, surface ships, submarines, space systems, radar, avionics, C4ISR, electronic systems, guided weapons and other defense products. However, since that announcement, and the lack of growth Segway experienced (UK defense and aerospace do not admittedly use Segways), international growth had seemed to come to a screeching halt.

However, 2003 Segway entered into global agreements with both France and Korea. In January 2003 Keolis Group and Segway LLC announced that they would enter into a partnership. Segway will work with Keolis to create ways to use Segways for public transportation applications in France.

Keolis is a private European company that operates in the passenger and transport sector. The company’s presence in France is large. It “covers about 40 percent of the market in the urban sector (86 urban centers) and 20 percent in the inter-urban sector.” Keolis works with a variety of transportation methods, including: buses (10,100 buses and coaches), metros, trams (operates 37.7 km), trolley buses, and the railway (66.5 km of automated light railway, 14.3 km of standard underground railway, 1,500 km of railways).

Keolis will be renting Segways to their commercial customers in the public transportation, airport and railway sectors. Customers will be able to rent Segway with Keolis employees training renters on how to use Segways. Keolis will also provide service, support, and training for rentals. The goal behind this agreement is to eventually have Segways used by the French public as an alternative form of transportation for short distances. Keolis will be Segways first international alliance that will push the Segways to consumers.

In November of 2003 Segway also announced an agreement LG International (LGI); where LGI would be the exclusive Korean distributor of Segways. LGI, also known as LG International Corp. is one of the largest marketing and distribution companies in Korea. The company's sales for 2002 were just over \$19 billion, with total revenues of \$85 billion. The company distributes high tech products to both consumers and businesses.

Plans for the Segway in Korea is similar to the strategy Segway took on in the US. First, the product will be available to business consumers, then to the rest of the market. A member of the second largest business group in Korea, LGI will pursue approvals for Segway HT use in public areas while vigorously addressing immediate opportunities for business and governmental use.

## **Shipyard Brewing Company: Offloaded In a Zero Growth Industry**

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*Presented at the REGULAR session of the Case Association 2004 Meeting*

Keywords: branding equity, brand management, marketing strategy, integrated marketing communications

### **ABSTRACT**

The Shipyard Brewing Company (SBC) had become a growing regional specialty brewer from southern Maine after starting as Federal Jack's Brewpub, Kennebunport, Maine. After several years of growing sales at pub, restaurant, convenience and chain grocery stores, Miller Brewing Company partnered with SBC, providing the marketing activity. After several years together, Miller decided to "Offload" SBC. This left SBC with the need to buy themselves back from Miller at a time when the craft beer industry had zero growth and was overcrowded.

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In April, 1999 Fred Forsley and Alan Pugsley, the founders of the Shipyard Brewing Company (SBC), received an email from a senior executive of Phillip Morris Inc. Phillip Morris was the owner of the Miller Brewing Company that was SBC's co-owner. The message announced that executives from another Phillip Morris business unit, Kraft, had replaced Miller's CEO, VP of Marketing and the Director of Sales. Fred and Alan were immediately concerned because the three former Miller executives were the people that they had negotiated their partnership with in November 1995. The partnership resulted in Miller performing the marketing function of SBC with Fred and Alan operating all of the brewing activities. Fred and Alan were fearful that trouble lay ahead.

In June 1999 Fred and Alan received a visit from Miller's general manager for SBC, its financial manager and a lawyer. The Miller executives were cordial but very business like as they explained that due to strategic changes at Miller and Phillip Morris, the joint ventures and/or acquisitions within the craft brewing industry into which Miller had entered in 1995 were all to be terminated. This meant that SBC and Celis Miller's former American Craft Specialty

Brewing Company (ACSBC) were to be sold or liquidated. ACSBC was the Miller organizational unit where SBC was located. Fred and Alan were reminded that the original ACSBC had been rolled into Miller corporate in 1996 at the time of Miller's shift from "portfolio" to "priority" sales strategy. The Miller executives further reminded Fred and Alan of the declining sales growth of the craft brewing industry that had fallen to 0% in 1998 that was inconsistent with their goals of market share growth for their brands.

Fred and Alan were told that they would be able to bid competitively for the Miller share of SBC. That statement raised anxiety in Fred and Alan as they did not know how it would complicate their bidding. They were also told that the price range would be for a 40,000-barrel annual capacity brewery, rather than the actual 96,000-barrel capacity that SBC had grown to become. The Miller executives realized that it would take time for Fred and Alan to arrange the necessary details for a buy-back of SBC. They concluded the meeting saying that they would wait to hear Fred and Alan's proposal.

After the Miller people had left, Fred and Alan returned to the conference room. They talked about the meeting that had just concluded. They also reminisced about the origins of their company, its rapid growth and their excitement when they teamed up with Miller for what they believed would be significant marketing support for SBC. They were grateful for the very fair price range that Miller would accept. Fred and Alan had a good relationship their bank, People Heritage Bank, Portland, Maine and felt confident that they would be able to raise the necessary funds. Where they were worried was that they knew that SBC had lost sales momentum in the past couple of years. The fact that Miller wanted out of the craft-brewing segment of the beer

industry was a clear signal that Miller didn't expect the craft beer industry to be profitable for them in the future. Fred and Alan knew that they had to increase sales volume immediately and continuously over the next several years in an industry that was not growing and may have become over-crowded.

## **CRAFT BREWING INDUSTRY**

The craft brewing industry<sup>1</sup> had experience spectacular growth in sales and in the number of brewers from 1985 to 1995. The craft brewers produced primarily ales and they were distinctive alternatives to the lighter brews distributed by the large national companies. From 1996 the growth slowed and ultimately diminished to 0% by 1998 (see exhibit 1).

### **EXHIBIT 1**

#### **Craft Beer Industry Annual Production (000) Barrels 1985 - 1991**

	<u>Year</u>	<u>Barrels</u>	<u>% Growth</u>
1985	<u>75</u>		
1986	<u>127</u>		<u>69 %</u>
1987	<u>220</u>		<u>73 %</u>
1988	<u>316</u>		<u>43 %</u>
1989	<u>491</u>		<u>55 %</u>
1990	<u>635</u>		<u>29 %</u>

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1991      854      34 %

Source: Institute for Brewing Studies, 736 Pearl St., Boulder, CO. 80306

**Craft Beer Industry: U.S. Regional Specialty Breweries, Micro Breweries & Brewpubs  
Operating**

<b><u>Year</u></b>	<b><u>Sales Growth</u></b>	<b><u>Brewpubs</u></b>	<b><u>Microbreweries</u></b>	<b><u>Regional Specialty</u></b>	<b><u>Total</u></b>
1992	39%	183	106	6	295
1993	40%	237	136	9	382
1994	50%	329	196	16	541
1995	47%	497	281	27	805
1996	26%	694	375	33	1,102
1997	4%	857	428	35	1,320
1998	0%	921	438	38	1,397

Source: Vol. 40. May/June, 2003. The New Brewer, The Journal of the Association of  
Brewers.

During the past six years, 1992-1998, the number of microbreweries and brewpubs that were opened was dramatic. During the industry's growth there were large numbers of brand names. Most brewers distributed only in their local areas, but the number of regional specialty brewers had increased steadily. By 1996 many microbreweries and brewpubs began closing as the industry retrenched (see exhibit 2).

**EXHIBIT 2**

**Craft Beer Industry Brewpubs and Microbrewery Openings and Closing**

<b><u>Year</u></b>	<b><u>Micros</u></b>	<b><u>Brewpubs</u></b>
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	<u>Openings</u>	<u>Closings</u>	<u>Openings</u>	<u>Closings</u>
1992	20	7	39	7
1993	32	3	69	14
1994	65	2	102	6
1995	92	3	195	24
1996	116	16	217	20
1997	92	39	215	53
1998	55	45	150	79

*Source:* Vol. 40. May/June, 2003. The New Brewer, The Journal of the Association of Brewers.

The sales volume at SBC declined during this period, as well (see exhibit 3)

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### **EXHIBIT 3**

#### **Shipyard Brewing Company Annual Sales (barrels)**

<u>Month</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>
January	0	1300	3211	1827	1310
February	0	1356	2779	2005	1552
March	0	2728	3339	2182	1784
April	0	2328	3560	2802	2126
May	624	2985	3173	3333	2337

June	1316	2869	4374	3595	2633
July	1258	2887	4001	4448	2533
August	1466	3181	3798	3703	2862
September	1071	2299	2997	2534	1930
October	1201	3253	2761	2470	1857
November	1404	2795	2515	1869	1780
December	1490	2474	2562	1869	1780
<b>Year Total</b>	<b>9,829</b>	<b>30,456</b>	<b>39,070</b>	<b>32,895</b>	<b>25,297</b>

## **SHIPYARD BACKGROUND**

SBC began as extension of Federal Jack's brewpub in Kennebunkport, Maine. In 1992 Federal Jack's was founded as a result of Fred's recommendation to open a brewpub in order to revive an under performing retail complex in town. In the early spring of that year Fred was hired a real estate consultant for the complex. He researched the idea of setting up a brewpub in the retail complex using the same brewing recipe and beer brands as a successful Portland brewpub, Gritty McDuff's. That failed to materialize, but during the negotiations Fred met Alan Pugsley, a brewmaster trained at the Ringwood Brewery in Hampshire, England under the tutelage of Peter Austin. Austin was considered the father of the craft brewing industry, when he founded Ringwood in the 1970s. Separately, Peter Austin and Alan Pugsley had set up numerous breweries in many countries and both had notable reputations.

Fred and Alan both liked the idea of a brewpub and partnered, establishing Federal Jack's brewpub in June 1992. Fred saw the brewpub initially as a way to bolster traffic at the retail

complex and as an entrepreneurial venture. Alan viewed the partnership as an opportunity to brew quality ales and have the satisfaction of owning part of the pub. The brewpub was located on a site with historic significance, “The Shipyard”, where in the 19<sup>th</sup> century three shipbuilding companies built schooners. Federal Jack was the name of one of the schooners and was depicted in the label of SBC’s first brew, Shipyard Export Ale. The brewpub had a seven-barrel batch system with an annual capacity of 1,800 barrel annual capacity. The first brews were Shipyard Export Ale and Goat Island Light, named for the brewpub’s site and an island off the southern Maine coast. Alan described Shipyard Export as blond or golden ale with a light coppery hue, full bodied yet lighter in flavor. Goat Island Light was a very light, low calorie beer with its own very distinctive flavor with notable body and the character missing in many light ales.

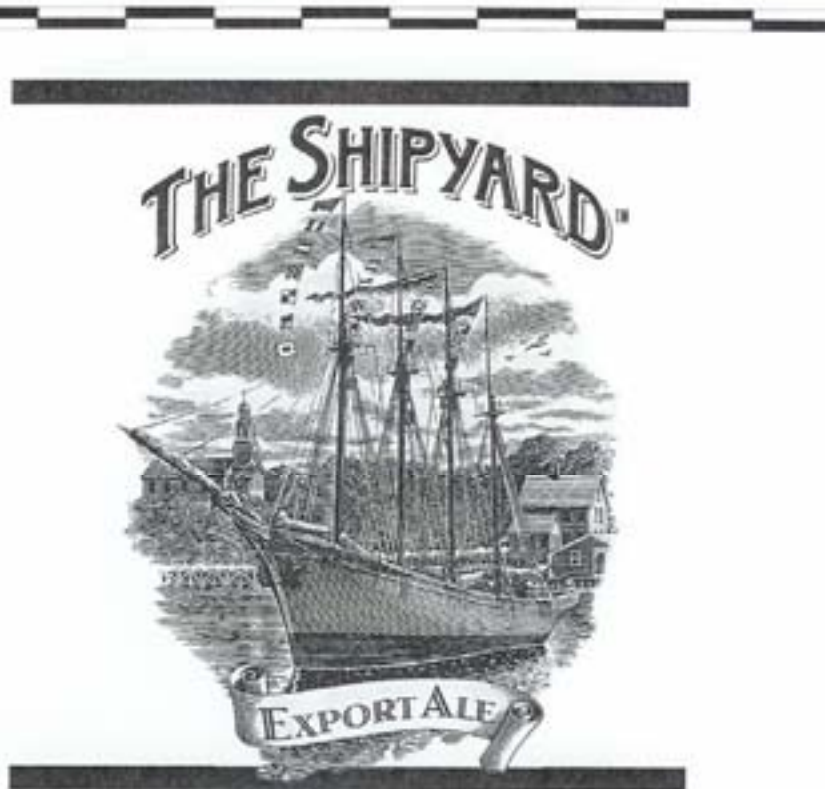
Ale sales at Federal Jack’s were good from the pub’s opening and continued throughout the summer season, but declined as the tourist trade diminished. In order to brew efficiently, sales had to be increased. As a result, Fred and Alan created the Kennebunkport Brewing Company (KBC) for selling the brews off premise. In the fall 1992 Fred had gained 20 pub and restaurant accounts and received good feedback and solid sales growth allowing KBC and operated its 1,800-barrel annual capacity efficiently. The pub and restaurant channel of distribution effectively reached the target market of 21 to 50 year olds, which were the greatest consumers of beer. Fred and Alan realized from their experience at Federal Jack’s that pubs and restaurants were effective channels for new ale trials and awareness building of the KBC brews.

### **Positioning**

The SBC ales were authentic English style ales and the flavors varied from full bodied to lighter ales. Fred and Alan believed that their ales were distinctive from the lighter beers distributed by

the national American companies, because of their flavors, body and colors. The different flavors made SBC ales good choices with a variety of foods. They chose the names Shipyard Export Ale and Goat Island Light because they related to SBC's Maine Coast location. Further, they believed the names would convey a traditional image for their brews, since the schooner-shipbuilding era was long since past. Oil paintings by Maine artists of 19<sup>th</sup> century schooners were used for SBC's logo and labels, when it eventually bottled the brews. As SBC's product line expanded, the same theme and label style were used (see figure 1).

Figure 1



*SHIPYARD EXPORT ALE*

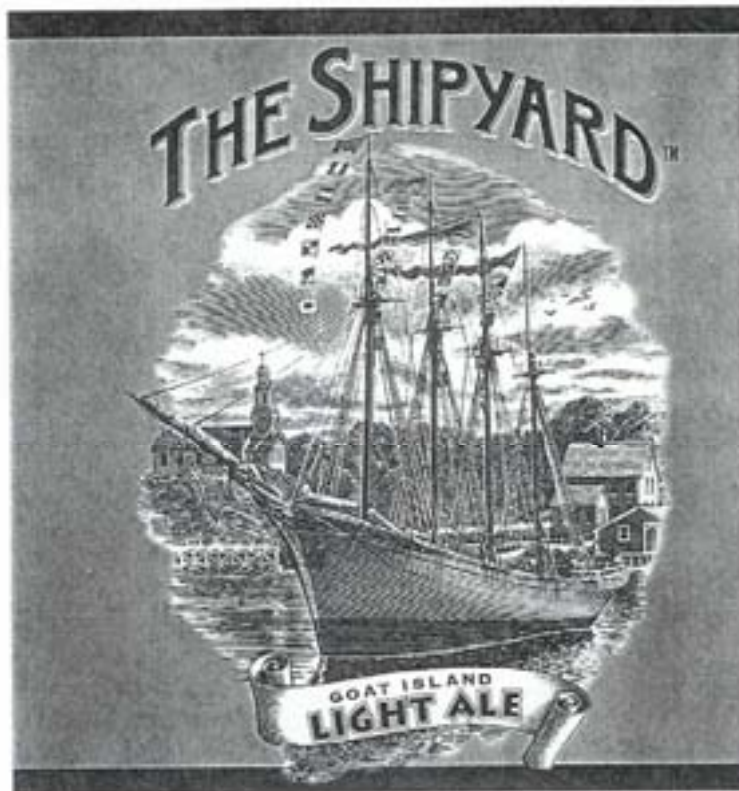
*Our flagship beer, Shipyard Export Ale is a full-bodied, old-style Canadian ale. Golden copper in hue, it's malty with a hint of sweetness upfront, and a dry, hoppy finish.*

*OG: 1052*

*Hops: Cascade, Willamette & Tettnang*

*Malt: Pale Ale, Crystal*

*Alcohol Vol: Vol = 5.1%*



### *GOAT ISLAND LIGHT*

*Goat Island Light Ale is a Shipyard Brewery favorite that is low in alcohol and surprisingly low in calories. Finally, a world class light beer that's superior to the imports.*

*OG: 1034*

*Hops: Tettnang & Willamette*

*Malt: Pale Ale & Maize Flakes*

*Alcohol Vol: Vol = 3.25%*

## **The management team**

Fred, KBC's president, was previously a real estate consultant in Portland. He was a charismatic person and tried to maintain a friendly and open culture around the brewery. He frequently held open forum meetings for all employees. Fred and Alan both believed that that type of business culture was most productive for a small and growing company. This same attitude was carried toward their suppliers and channel of distribution members. Fred viewed them as "partners" and believed that good relationships with them were critical in producing and selling quality brews. Fred liked to say that he wanted to "kill'em with kindness" and that it would be an approach they strived to take.

Alan was the brew-master. He carefully selected which suppliers to use for hops, malts and other supplies and equipment. He was the head of brewing and also did the brewery's hiring. Alan selected people based on their genuine desire to become a brewer and make quality ales, as well as their ability to be a loyal team player.

In the spring 1993, Bruce Forsley, Fred's cousin, joined KBC to assist in building the sales distribution network. Bruce was experienced in the restaurant and tavern industry and was the co-owner of two restaurant-taverns, the Silver Street Tavern in Waterville, Maine and the Silver Street Grille in Portland.

## **Sales growth**

Sales of KBC ales were strong from the beginning at Federal Jack's. In December 1992 alone, KBC sold 430 barrels. In February 1993, KBC expanded its capacity up to 3,600 barrels

annually. In June of that year KBC expanded again up to 5,100-barrel annual capacity. In July KBC began bottling and distributed its 12 and 22 ounce bottles through convenience stores. Later brand extensions followed maintaining KBC's product strategy of brewing authentic English style ales. The bottles' labels attempted to convey a traditional image and were similar to the earlier Shipyard Export and Goat Island Light labels (see figure 2). In addition, Old Thumper, an English ale, was brewed under a licensing agreement with Ringwood Brewery, Hampshire, England.



Figure 2




SHIPYARD BREWING COMPANY		PRODUCT SHEET	
*56 Newbury Street Portland, Maine 04101 (207) 761-0807 *Orlando Int'l Airport Main Terminal, Level 3 Orlando, FL 32827 (407) 825-6474			
<b>MALT</b>	2-Row British Pale Ale, Crystal, Chocolate, Black & Roasted Barley  Northern Brewer Cascade, Torrington & Goldings	2-Row British Pale Ale, Crystal & Roasted Barley  Northern Brewer Cascade, Torrington, Fuggles	2-Row British Pale Ale, Crystal & Malted Wheat  Fuggles
<b>HOPS</b>	Northern Brewer Cascade, Torrington & Goldings	Cascade, Willamette, Torrington	Torrington & Willamette
<b>YEAST STRAIN</b>	Top-Fermenting English	Top-Fermenting English	Top-Fermenting English
<b>AVAILABILITY</b>	Year Round	Year Round	Year Round
<b>FLAVOR CHARACTERISTICS</b>	Initial malt & cereal flavors with dry roasted finish	Smooth texture and softness, sweet finish, hint of chocolate & maple	Smooth, dry & crisp flavor with floral aroma & apple phenol notes
<b>FOOD PAIRINGS</b>	Wonderful with dressings, especially anything chocolate	Great with pork and pears	Searing shellfish, salads and other light fare
<b>COLOR</b>	Jet Black	Golden Copper	Light Copper
<b>AVAILABLE FORMATS</b>	12 oz Bottle, 22 oz Bottle, Keg	12 oz Bottle, 22 oz Bottle, Keg	12 oz Bottle, 22 oz Bottle, Keg, Cask Conditioned
<b>FIRST BREWED</b>	February 1993	June 1992	June 1992
<b>OG</b>	1052	1052	1060
<b>ALC. % VOL/VOL</b>	4.7%	5.1%	5.2%
			October 1996
			1060
			5.0%

Figure 2 Continued

SHIPYARD BREWING COMPANY		THE SHIPYARD BREWING CO. PRODUCT SHEET	
<p>*66 Newbury Street Portland, Maine 04101 (207) 781-0807 *Orlando Int'l Airport Main Terminal, Level 3 Orlando, FL 32827 (407) 825-6474</p>			
MALT	<p><b>Seasonal</b> 2-Row British Crystal, Chocolate &amp; Biscuit Biscuit</p> <p><b>Seasonal</b> 2-Row British Pale Ale, Crystal, Chocolate &amp; Tortured Wheat</p> <p><b>Seasonal</b> 2-Row British Mosaic, Pils Ale &amp; Malted Wheat</p>	<p>Northern Brewer Cascades, Terrapin, Goldings</p> <p>Top-Fermenting English</p> <p>October - March</p>	<p>Top-Fermenting English</p> <p>October - March</p> <p>April - August</p>
HOPS	<p>Full bodied, strong also with a distinct rounded hoppy character</p> <p>Heavy stick-on-rolls fan like aroma, excellent for kidney pie</p>	<p>Perfect with desserts or as a dinner beer</p> <p>Deep Amber</p> <p>12 oz Bottle, 22 oz Bottle, Keg</p> <p>December 1993</p>	<p>Mellow malty wheat flavor with low hoppy characteristics</p> <p>Great with seafood</p> <p>Golden</p> <p>12 oz Bottle, Keg</p> <p>June 1995</p>
YEAST STRAIN	<p>Top-Fermenting English</p> <p>October - March</p>	<p>Top-Fermenting English</p> <p>October - March</p>	<p>Top-Fermenting English</p> <p>April - August</p>
AVAILABILITY	<p>October - March</p>	<p>October - March</p>	<p>April - August</p>
FLAVOR CHARACTERISTICS	<p>Full bodied, strong also with a distinct rounded hoppy character</p> <p>Heavy stick-on-rolls fan like aroma, excellent for kidney pie</p>	<p>Perfect with desserts or as a dinner beer</p> <p>Deep Amber</p> <p>12 oz Bottle, 22 oz Bottle, Keg</p> <p>December 1993</p>	<p>Mellow malty wheat flavor with low hoppy characteristics</p> <p>Great with seafood</p> <p>Golden</p> <p>12 oz Bottle, Keg</p> <p>June 1995</p>
FOOD PAIRINGS	<p>Perfect with desserts or as a dinner beer</p> <p>Deep Amber</p> <p>12 oz Bottle, 22 oz Bottle, Keg</p> <p>December 1993</p>	<p>Perfect with desserts or as a dinner beer</p> <p>Deep Amber</p> <p>12 oz Bottle, 22 oz Bottle, Keg</p> <p>December 1993</p>	<p>Great with seafood</p> <p>Golden</p> <p>12 oz Bottle, Keg</p> <p>June 1995</p>
COLOR	<p>Dark Brown</p> <p>12 oz Bottle, 22 oz Bottle, Keg</p> <p>February 1995</p>	<p>Deep Amber</p> <p>12 oz Bottle, 22 oz Bottle, Keg</p> <p>December 1993</p>	<p>Golden</p> <p>12 oz Bottle, Keg</p> <p>June 1995</p>
AVAILABLE FORMATS	<p>12 oz Bottle, 22 oz Bottle, Keg</p> <p>February 1995</p>	<p>12 oz Bottle, 22 oz Bottle, Keg</p> <p>December 1993</p>	<p>12 oz Bottle, Keg</p> <p>June 1995</p>
FIRST BREWED	<p>February 1995</p>	<p>December 1993</p>	<p>June 1995</p>
CG	<p>1062</p>	<p>1079</p>	<p>1090</p>
Alcohol % Vol.:Vol.	<p>5.9%</p>	<p>6.8%</p>	<p>5.1%</p>

Fred and Alan realized that it needed a brewery closer to the tavern market in Portland and that it also needed additional capacity. On September 11, 1993 KBC commenced the City of Portland's approval process for acquiring a vacant foundry for the purpose of building a new brewery. The foundry's property happened to be the site of Henry Wadsworth Longfellow's birthplace and was located just off the waterfront, adjacent to Portland's Old Port. This part of Portland had many pubs and restaurants and drew people from out of town and tourists. In November Fred and Alan closed on the property.

In April 1994, the Portland brewery opened and with it the company named was changed to the Shipyard Brewing Company (SBC). Press releases were issued to the area media that announced the opening. In the summer a huge mural of the Federal Jack schooner, much like the label of Shipyard Export Ale, was painted on the most prominent wall of the brewery. As part of the celebration of the brewery's opening, Fred gave numerous tours of the brewery to the media personnel, distributors, tavern, restaurant, convenience and liquor stores owners. Fred believed that in order to expand sales he must communicate SBC's core values to all constituents and at all opportunities. He did this through during the tours, press releases and numerous personal contacts. Fred believed that SBC values were: quality authentic English style ale, locally brewed, viewing all channel of distribution members as "partners" and a genuine commitment to the community in general. Tours were also given for the general public and tourists. In the summer months, a van was used to pick up tourists from the Old Port and shuttle them to the brewery. Also, SBC opened a store at the brewery and sold a variety of quality products bearing

the SBC logo, including: tee shirts, baseball hats, sweatshirts, mugs, book on brewing and jackets.

SBC received publicity from numerous newspaper stories that cited its new brew introductions and plant expansions. SBC was selected Portland's best micro brew in 1994 and was awarded the World Beer Tasting Gold medal for its Blue Fin Stout.

Fred and Bruce continued to expand sales by securing additional pubs and restaurants. All product deliveries were required by law to be handled by independent distributors. When making sales calls, they emphasized that SBC brewed authentic English style ales and noted Alan's reputation as a brew-master. Fred believed that taking a personal approach to the sales calls was important for establishing a relationship with these accounts. Fred and Bruce strived to "kill them with kindness" as they paid attention to the small businesses' need for support treated them as "partners" in the effort to sell quality brews. Fred and Bruce offered as educational support for the wait-staff of pubs and restaurants that included product sampling, food pairings and insights into the brewing process. They explained how to have beer dinners, serving the appropriate brew with each course. Shipyard pint glasses, napkins, table tents were offered as promotional support, along with tee shirts for interested wait-staff. Sales incentives, gift certificates for instance, were also used to build follow through with the wait-staff personnel. In addition, the pubs and restaurants in Maine received cooperative radio advertising support. SBC offered to have its Shipyard jingle, "your ship has come in...Shipyard Ale" used at the end of radio ads for happy hour events when SBC brews were featured. He viewed this kind of promotion as synergistic with the other promotional efforts and valuable support for the pub

owner. They always gave SBC Product Sheets that showed all of the brands with their brewing details and food pairings (see Exhibit 5).

Convenience and liquor store were targeted as well. These outlets valued the addition of SBC brands to their offerings as another way of giving distinctive product choices to their customers. Fred and Bruce supported these accounts with merchandising aids that included banners, static pictures for coolers, shelf cards and border display wrap for around the bottom of cases that were displayed. For more important accounts neon signs, mirrors with the Shipyard logo and framed acrylic prints of the Shipyard label were offered. The SBC Product Sheet was always given as a summary of all of the brews and their varying characteristics. The amount of point of sales support was regulated and limited to \$300 per year and a maximum of \$1,000.

Around February 1994, the Maine grocery chain, Hannaford, agreed to carry the brews. The buyer for beverages happened to be a beer lover and was willing to take a chance on the sales volume of SBC and other local brewers would generate. In addition, Bruce was able to secure an 18 month long exclusive sales arrangement with Cappies, a 12-store liquor chain in Massachusetts for the eastern section of the state. This was SBC's first outlet in that state. In the fall of 1994, East Coast Beverages, a distributor for central Massachusetts began carrying SBC brews. About this time sales penetration was made in southern New Hampshire, Vermont and Connecticut.

The SBC sales approach was always one of attempting to establish a personal relationship with all of its channel members. This meant that in addition to merchandising support, they invited

new accounts to visit the brewery in Portland. During the brewery visits, Fred, Alan and Bruce were very hospitable, entertaining guests with samples the various brews and explanation of brewing and the recipe differences. Brewery visits often concluded with dinners out to Portland's Old Port restaurant district.

The bottled brews that were sold to convenience, liquor and grocery chain stores were packaged in 12 ounce, six and twelve packs and limited offerings of 22 ounce bottles. Later, when more brews had been added, SBC offered the Captains Collection, which was a twelve pack that contained a variety of the SBC brews. The retail prices were between \$6.49 and \$7.99 for six packs and between \$9.99 and \$12.99 for the twelve packs. These prices were very competitive with other craft brewers and super-premium beers. Shipyard Export Ale six packs retailed at \$5.99. It was priced lower than the others because it was SBC's core brand and had higher production volume.

By the spring of 1995, the sales force expanded to include two marketing reps in Massachusetts, one in Connecticut, one rep in New Hampshire and one in Maine, in addition to Bruce, the sales manager. The reps made servicing and new account calls on all of the outlets: pub, restaurant, convenience, liquor and grocery chain stores. All deliveries were handled by distributors, as was required by law. SBC offered its distributors' sales reps incentives for opening a certain number of new retail accounts, such as: LL Bean's gift certificates, weekend travel opportunities to Florida, for example and sometimes cash. In all cases, the SBC reps made special effort to maintain the "kill'em with kindness" approach that Fred and Bruce successfully deployed.

SBC was a regular exhibitor at industry tradeshows and brew exhibitions. It displayed and sold its brews at the Portland International Jetport. SBC believed in being an active participant in the community and sponsored numerous non-profit organization events, for example: outdoor events like “Let’s Go Boating”, an area boat show, “Beach to Beacon” the internationally known, 10k road race from Cape Elizabeth to Portland Head Light” and the M.S. Regatta, a yacht race off Portland’s Eastern Promenade, skiing and tennis events. At these events Shipyard banners were displayed at appropriate locations. Also, for community events where volunteer appreciation parties were held, SBC often donated Shipyard Export Ale. Other community events sometimes received a direct contribution of funds. SBC had also contributed funds to the York County Education Fund that benefited York County high school seniors. It also contributed funds to York County Technical College’s culinary arts program.

In early 1995, the Miller Brewing Company was looking for fast growing craft breweries to add to its American Specialty Craft Beer Company (ASCBC). ASCBC had already marketed Celis Brewing Company from Austin, Texas and Jacob Leinenkugel Brewing Company of Wisconsin. One of Miller’s key distributors had talked to a SBC distributor, which lead to a Miller contact with SBC. At this time Fred and Alan were searching for an additional partner or other sources of capital to enable the company to grow faster. Fred and Alan ultimately negotiated a deal with Miller executives in November 1995. The partnership resulted in Miller conducting the marketing side of the business with Fred and Alan retaining the brewing operations. Refer to exhibit 4 for a summary of SBC plant developments and production introductions.

#### **EXHIBIT 4**

## **Chronology of SBC and KBC's plant developments**

### **1992**

June 1992 Federal Jack's Brewpub is opened with 1,800 bl. annual capacity.

Fall 1992 Distribution to area tavern began.

December 1992 Annual sales were 430 bls.

### **1993**

February 1993 KBC expanded to 3,600 bl. annual capacity. Blue Fin Stout introduced.

April 1993 Moose Brown Ale introduced.

June 1993 KBC expanded to 5,100 bl. annual capacity

July 1993 22 oz. bottling of Shipyard Export began and 5 liter mini kegs.

September 1993 Consideration began for building an additional brewery

November 1993 Forsley closed on real estate for the SBC.

November 1993 Contract Brewing began as an interim capacity initiative.

December 1993 Prelude Ale introduced ( a special edition brew available only for the holidays)

### **1994**

January 1994 Construction began for the SBC.

February 1994 Blue Fins Stout and Goat Island Light became available in 22 oz. bottles.

April 1994 SBC opened with 18,000 bl. annual capacity.

May 1994 Shipyard Export became available in 12 oz. Bottles.

November 1994 Old Thumper introduced in 12 oz bottles.

December 1994 Annual sales of 9,500 bls. Longfellow Winter Ale introduced ( special edition available only in winter months)

### **1995**



February 1995 SBC increased its annual capacity to 36,000 bls.

March 1995 Blue Fin Stout, Goat Island Light Ale, Moose Brown Ale introduced in 12 oz. bottles.

June 1995 Chamberlain Pale Ale introduced in 22 oz bottles.

July 1995 SBC increased its annual capacity to 54,000 bls.

July 1995 KBC (at Federal Jack's pub) reduced its annual capacity to 3,600 bls.

November 1995 The partnership with the Miller Brewing Company is signed.

December 1995 annual sales were 30,500 bls.

## **1996**

Spring 1996 SBC added Kronos bottling line and increased its annual capacity to 96,000 bls.

December 1996 Annual sales were 39,000 bls.

## **1997**

April 1997 SBC opens its brewpub at the SBC Brewport at the Orlando International Airport with 5,200 bls. annual capacity.

## **MILLER TIME**

In 1995 The Miller had implemented its "portfolio" selling strategy, which meant that the whole Miller network was organized so that its sales force could sell their whole portfolio of beer. This included the ACSBC brands and Miller's national brands that included Miller High Life, Miller Lite, Miller Beer and Miller Draft. About the same time that SBC partnered with Miller, Molson of Canada, Fosters of Australia and Presidente from the Dominican Republic had been acquired. The portfolio strategy allowed the Miller's sales force to draw upon a variety of

resources to sell their entire portfolio of beers. Miller used exclusively large distributors, rather than specialty distributors, since that was needed to accommodate the volume that Miller generated with all of its brands. According to Bruce, Miller also tended to “pay up front” for its market share. What this meant was that Miller would spend for media advertising for its brands and then attempted to influence its distributors to follow its lead. It was a forceful approach, according to Bruce.

In early 1996, Miller installed a Krones bottling line at the SBC valued at approximately \$5.5 million. That capital investment and other equipment increased its capacity to 96,000 barrels annually. The Krones bottling process enabled SBC to increase its products’ quality because less air got into the bottles during bottling and improved seals for its caps. Higher quality glass bottles were also used. As a result, shelf life was extended from 3 to 12 months. The labor needed for bottling was cut in half and improved the brewing safety systems. Further, Alan had access to Miller’s labs and expanded his brewing knowledge.

In July 1996 Miller changed its strategy from “portfolio” to “priority” selling. Miller decided to shift its sales approach because its major brands were facing keen competition from other national brewers. This meant that instead of Miller providing marketing resources to all of its brands, including the ASCBC, it concentrated the resources on its priority brands, Miller High Life, Miller Beer, Miller Draft and Miller Lite. That resulted in each brand reporting directly to the Miller marketing management. The change hurt the specialty brews and lower market share brands, as they did not receive the marketing support they enjoyed under the “portfolio” strategy.

During 1996-97 Miller's marketing management directed Fred to focus upon out of state sales expansion. Maine and New Hampshire markets were doing okay and Miller management believed that those markets were about saturated. Fred followed Miller's direction and worked on gaining distributors in outlying areas where Miller was strong and that the SBC brand had relevance. Miller believed that other coastal communities would relate to the SBC brand. These markets included: Long Island and Buffalo, New York, the New Jersey shore, Annapolis, Atlanta and Chicago. Fred worked hard in attempting to establish personal relationships with new distributors, but travel and entertainment expenses for Fred were high. After a new distributor agreed to handle the SBC brands, the regular Miller sales force took over. Fred felt that the shift to Miller the sales people brought the culture of a big corporation to the channel member relationships. Being a large corporation, Miller had a lot of sway with the distributors, that was sometimes resisted, since they were independent businesses and were primarily concerned with the products that made the best profit for them.

Other difficulties with the distributors surfaced. For example, in July 1996 MDI, an independent distributor in Illinois, joined the Miller distribution network. Eight months later, MDI bought the rights to market Sam Adams, which enjoyed higher margins and greater sales volume. It lost interest in supporting Miller brands, including SBC's. In New Jersey a change from a successful independent distributor to six Miller distributors resulted in serious loss of sales. Since 1996, when Miller shifted to "priority" sales strategy, SBC received less and less marketing support.

In 1996 SBC received a contract from Magic Hat Brewery to brew 8,000 barrels, which turned out to be 20% of that year's production. Also, Wharf Rat, a Baltimore microbrewer contracted

brewing with SBC for a lesser quantity. In 1997 the Miller management required SBC to end the contract brewing stating that it was a distraction.

In April 1997, SBC successfully opened a brewpub at the Orlando International Airport. This was the first ever brewpub in any airport in the U.S. The high traffic of the airport and the southern location were viewed with excitement. Fred felt that it would gain solid awareness for the SBC brands in the South.

In 1997-98 the craft beer industry suffered what Alan referred to as a “wobble”. The craft beer industry that had enjoyed expansive growth but now it had slowed to zero. According to Fred, retailers were confused with the numerous craft brands that had been introduced during the craft beer industry growth years. SBC sales declined. Fred and Alan were concerned and knew that they needed to receive reasonable sales per brand to justify keeping them on the shelf. Miller management noted the trend in the craft beer industry and the difficulties SBC was having with its distributors in its more distant markets, directed Fred to drop out of New York, Illinois, New Jersey, Maryland and Georgia. In the fall of 1998 in an effort to boost volume, Fred convinced Miller to allow SBC to contract brew 3,500 barrels for a small Maine brewery, Sea Dog.

## **THE FUTURE**

As Fred and Alan mulled over the meeting that they had just concluded with the Miller managers, the idea of being “offloaded” was giving mixed feelings to each of them. All in all, the relationship with Miller was a positive joint venture. Both Fred and Alan felt excited,

however, about the chance to buy-back their company. They felt confident that the bank would support them, especially since Miller had been very fair in setting a price in the range of a 40,000-barrel brewery and not the 96,000-barrel facility that SBC had become. Cooling their enthusiasm was their belief that the craft brewing industry may be overcrowded and that SBC had lost its sales momentum in the past two years.

Fred and Alan estimated that they needed to boost sales 5% per year for the next several years to achieve brewing efficiency. What marketing strategy should they follow? Were there product or brand changes that should be made? What geographic markets should they concentrate upon? How should they promote the SBC brews now that Miller was not involved?

<sup>1</sup> **END NOTES**

As of October 27, 2003 beertown.org, the Association of Brewers, Boulder, CO web site, defined several categories of brewers: microbreweries produce less than 15,000 barrels per year; brewpub are restaurant-brewery that sells the majority of its beer on site and less than 15,000 barrels per year; contract breweries hires another company to produce its beer; regional brewery has a capacity of between 15,000 and 2,000,000 barrels annually; regional specialty brewery is a regional brewery whose flagship brew is an all malt or specialty beer; craft brewer is any of the above whose majority of sales are considered craft beers.

## References

Shipyard Documents and interviews. Shipyard Brewing Company, 86 Newbury Street, Portland, Maine 04101.

Institute for Brewing Studies, 736 Pearl St., Boulder, CO. 80306

Vol. 40. May/June, 2003. The New Brewer, The Journal of the Association of Brewers.

## **TEACHING NOTE**

### **SYNOPSIS**

The Shipyard Brewing Company (SBC) had become a growing regional specialty brewer from southern Maine after starting as Federal Jack's Brewpub, Kennebunkport, Maine in June 1992. After solid sales during the first summer of operations, the brewery began distribution to other brewpubs, restaurants and retail stores. Over several years it added brewing capacity to match its sales growth. In 1995 the Miller Brewing Company partnered with SBC performing the marketing function, while SBC did all of the brewing at its Portland, Maine brewery. In 1996 Miller's marketing strategy had reprioritized, which resulted in diminishing marketing support for SBC. From 1996-98 the craft brewing industry had stopped growing and as a result of this and Miller's reprioritization of its craft brewers, a decision was made by Miller to exit the craft brewing joint ventures it had entered into. The two founders of SBC were given the opportunity to buy back the outstanding shares, 50%, from Miller. Their challenge was to increase sales in an apparently overcrowded industry, where growth had dropped to zero in order to reach an efficient production level.

### **RESEARCH BASIS OF THE CASE**

The research basis of this case was primarily based on interviews with SBC executives and industry facts from: the Institute for Brewing Studies, 736 Pearl St., Boulder, CO. and Vol. 40. May/June, 2003. The New Brewer, the Journal of the Association of Brewers.

### **APPROPRIATE COURSES**

This case is appropriate for use in undergraduate classes in marketing, integrated marketing communications, entrepreneurship and sales management.

## **STUDENT LEARNING OBJECTIVES**

1. Students will be able to evaluate the brand equity of SBC and to understand how strong brand equity is built.
2. To understand the importance of brand relationships with stakeholders and how trust in brands contributes to brand value.
3. To evaluate product labels in terms of their contribution to positioning and sales appeal.
4. To understand alternative marketing strategies for increasing sales volume.
5. Evaluate brand extensions decision-making and product strategy.

## **PEDAGOGY**

This case could serve as the basis of brand management discussion for advertising and marketing classes. For marketing classes the case can provide the basis for discussion of various strategic alternatives for sale increases. It could be useful in entrepreneurship classes as an example of a successful start-up venture and to demonstrate the benefits and risks of becoming part of a large corporation. For a sales management class, the case provides a situation to discuss territory coverage and distributor relations.



## **SUGGESTED CASE QUESTIONS**

1. Evaluate the brand equity of the SBC brands. Describe how the brand equity was built. How were the SBC brands positioned? Discuss the image that you believe the brands project?
2. Describe the brand relationship that SBC had with its stakeholders? What is the importance of trusting a brand by various stakeholders?
3. Evaluate the labels used by SBC. Do you recommend any changes?
4. Do you agree with SBC's rapid brand extensions? What are the benefits and risks of rapid brand extension?
5. Conduct a Strengths, Weaknesses, Opportunities, Threats (SWOT) analysis.
6. What strategic alternatives did SBC have for increasing sales 5% annually, for several years in order to achieve production efficiency?

## **ANALYSIS**

- 1. Evaluate the brand equity of the SBC brands. Describe how the brand equity was built. How were the SBC brands positioned? Discuss the image that you believe the brands project?**

Brand equity is the intangible value of a company beyond its physical net assets. The accounting term for brand equity is goodwill. The steps in building a brand include:

1. Selecting the name and symbol.
2. Creating awareness and brand identity of name and symbol.
3. Positioning the brand to begin differentiating it from competing brands.
4. Create a brand image to help further differentiate the brand and to make it easier to recognize and recall.
5. Create trust in the minds of customers, prospects and other stakeholders about the brand by maintaining consistency and delivering on expectations.

The brand name, Shipyard, was selected as an image evoking name that suggests tradition. It was also chosen because of the original location of what became the Shipyard Brewing Company. The Shipyard symbol was taken from an oil painting that depicted a schooner that was built on the property of Federal Jack's brewpub.

Fred and Bruce Forsley along with Alan Pugsley created awareness and identity for the Shipyard brands through communication of the brews' authentic English character. This was accomplished through personal selling by Bruce and Fred to pubs and restaurants, retail stores and the distributors that handled SBC's brews. The message given focused upon the authentic recipes and ingredients used, the food pairings for each brand, the brewing process and Alan's training at the Ringwood Brewery in England. The Product Sheet (exhibit 5) summarizes the product facts. The wait staffs at pubs and restaurants were informed of the above listed features of Shipyard products and they were given incentives for sharing the information with their customers. Awareness was also created through consumer product trials at the pubs and restaurants. Press releases were issued to area media whenever SBC had news: new brand introductions, brewery capacity expansion, etc.

The brands were positioned as authentic English ales and used the brand names and symbols to help communicate Shipyard's identity. The symbols used were based on oil paintings of 19<sup>th</sup> century schooners were intended to create a traditional New England image.

Reference: Duncan, T. (2002). IMC: Using Advertising and Promotion to Build Brands. 1<sup>st</sup> ed. NY, NY: McGraw-Hill.

- 2. Describe the brand relationship that SBC had with its stakeholders?  
What is the importance of trusting a brand by various stakeholders?**

### **Customers**

Fred and Alan believed in their product and honestly wished to produce a truly authentic English ale. To succeed they needed to build a customer base that enjoyed their products enough to buy them regularly. This was accomplished from the beginning with the positive response they received from their Federal Jack's customers. Solid feedback continued as they began selling to pubs and restaurants in the fall of 1992 and spring 1993 that resulted in 20 accounts. Sales continued to increase as SBC expanded its geographic coverage until 1996. In 1997-98 sales had fallen, as a result of the overcrowded nature of the industry.

### **Employees**

Employees are critical stakeholders as they directly contribute to quality products. Fred and Alan valued loyalty from their employees and believed that good people make a difference when the goal is producing quality ale. Fred was a charismatic figure and had a loyal "family" attitude toward his employees. Fred was an approachable boss and frequently held open forum meetings with all of his

employees. As a result of a positive company culture, the Shipyard brand equity is raised as those who work for the company generate word of mouth advertising in their spheres of influence.

### **Suppliers**

Alan and Fred carried the same loyal attitude toward their suppliers. Fred and Alan were business like in negotiating their supply requirements. Alan knew exactly the types of hops, malts, yeasts and other ingredients that would yield authentic brews. He carefully selected suppliers that were able to supply the right ingredients and other brewing needs and then treated these companies as partners and strived to maintain long-term business relations. Fred and Alan believed that long-term business relationship would result in better service than would result more frequent changes in suppliers. They also believed that good relations would generate positive word of mouth advertising in the industry.

### **Public**

Fred and Alan believed in being active in their communities. They supported community events and donated Shipyard ales for volunteer parties hosted by non-profit and community service organizations; the Beach to Beacon 10K road race and the MS Regatta, for instance. SBC also displayed its banners sponsored events that were visible to the attending public. Fred and Alan believed that

sponsorships contributed in a subtle, but important way to their brand image. Press release were sent to the media whenever a new brew was launched or other news events, brewery expansions and the York County Education Fund that benefited York county seniors and York County Technical College's culinary arts program.

### **Distribution Channel Members**

SBC's sales force followed what Fred referred to as a "kill with kindness" approach to their channel members. They were always friendly and supportive of the channel members' need for profit generating products. At the convenience store level SBC sales reps provided merchandising materials, such as display wraps and banners for in store merchandising support. Pubs frequently received SBC radio advertising support announcing happy hour specials when they featured SBC ales. Restaurant and pub wait-staff received food pairing information and incentives for supporting SBC ale sales. Distributors received brewery tours and samples, along with being apprised of the support SBC gave its stores, pubs and restaurants. As with suppliers, SBC treated its channel members as valued partners.

### **Bank**

Fred and Alan had a good relationship with its bank. SBC had grown steadily and was always able to meet its loan payments on time.

SBC worked at building and maintaining strong relationships with all of its stakeholders. The most important of the stakeholders is the customer, followed by employees. The next important stakeholders are a company's financial investors and distributors. The importance of these efforts was to build brand equity at various levels through overlapping interactions and communications. Together brand value was strengthened through strong stakeholder focus.

Reference: Duncan, T. (2002). IMC: Using Advertising and Promotion to Build Brands. 1<sup>st</sup> ed. NY, NY: McGraw-Hill.

**3. Evaluate the labels used by SBC. Do you recommend any changes?**

The labels appear very effective for the purpose of supporting the brand position SBC set out to capture. The labels were taken from original oil paintings that depict a 19<sup>th</sup> century schooner. The intention was to create a traditional image to convey the nature of SBC ales that being authentic English style ale. The arched lettering of the word Shipyard is the banner of the label and does emphasize the brand name. The particular flavor name was printed on a scrolling banner at the bottom of the label.

A critical comment would be that the schooner image maybe smaller than it could be. The flavor name banner could be enlarged for the purpose of it being more easily read when the product was on a shelf or in a cooler. Both issues were

addressed in 2000. The schooner image was enlarged slightly and Goat Island Light Ale had its name changed to Light Ale and the words highlighted. Fuggles IPA label changed to an arched and enlarged IPA just below The Shipyard arch. The two seasonal brews, Winter Ale and Summer Ale, had their label changed by enlarging their names on the label. All of these adjustments made the brews stand out more clearly on the shelf and cooler (see exhibit TN-1).

4. Do you agree with SBC's rapid brand extensions? What are the benefits and risks of rapid brand extension? Should SBC continue extending its brand name?

The benefits of extending the Shipyard brand were:

1. Improve brand image
2. Reduce risk perceived by customers
3. Increase probability of gaining distribution and trial
4. Increase efficiency of promotional expenditures
5. Reduce costs of introductory and follow-up marketing programs
6. Avoid costs of developing new brands
7. Allow for packaging and labeling efficiencies
8. Permit consumer variety-seeking
9. Bring new customers into brand franchise and increase market coverage



Risks or disadvantages of extending Shipyard's brand were:

1. Can confuse consumers
2. Can encounter retailer resistance
3. Can fail and hurt parent brand
4. Can succeed but cannibalize sales of the parent brand
5. Can succeed but hurt the image of parent brand
6. Can dilute brand meaning
7. Can cause the company to forgo the chance to develop a new brand

Taken as a whole the benefits outweigh the risks, as SBC demonstrated its ability to increase distribution and sales in numerous markets, improve its overall brand image, avoid costs of developing new brands, allow for packaging efficiencies, permit consumer variety and ultimately strengthen the brand. The relevant risks were failure of individual extensions causing damage to the brand. It was also possible that an extension might only take away sales from another SBC brew and cannibalizes sales of its predecessor.

SBC should continue introducing new recipes and flavors as long as they are distinctive from other SBC brews or replace one that may suffer from poor sales.

SBC introduced three new brews since the buy-back: Light Ale replaced Goat Island Light, Winter Ale and Pumpkinhead Ale (see exhibit TN-1).

Reference: Keller, K.L. (2003). Building, Measuring, and Managing Brand Equity. 2<sup>nd</sup> ed. Upper Saddle River, NJ: Prentice Hall.

**5. Conduct a Strength, Weakness, Opportunity, Threats Analysis (SWOT).**

**Strengths**

1. SBC brewing capacity of 96,000 barrels annually is large enough for SBC being a regional brewery.
2. Kronos bottling line results in a 12 month long shelf life for the brews.
3. Alan Pugley's brewing ability and reputation
4. Fred Forsley's entrepreneurial ability and charismatic personality
5. Bruce Forsley's pub and restaurant experience
6. Strong brand equity
7. Strong stakeholder relations

**Weaknesses**

1. SBC lost momentum when Miller shifted from portfolio sales to priority sales approach.
2. In 1998 SBC has pulled out of the NY, IL, NJ, MD, GA markets. This left a negative impression of channel members.

3. Fred was unable to be sufficiently entrepreneurial under the Miller management. Budgeting and marketing planning directed by Miller was developed and followed annually. This was not effective for SBC and inhibited Fred's entrepreneurial responses to market conditions.

### **Opportunities**

1. Rejuvenate the Maine and New Hampshire markets
2. Re-enter states where SBC had been under SBC management.
3. Establish channel member relationships by applying the SBC "kill them with kindness" approach and treat channel members as "partners" in supporting their efforts for profitable merchandising.
4. Introduce new flavors as opportunities dictate.

### **Threats**

1. Sales growth of craft beer had slowed dramatically in recent years.
2. The number of brew-pubs, micro breweries and regional craft brewers had continued to increase, even though craft beers sales growth had declined to 0% in 1998 . The craft brewing industry appeared to be overcrowded.
3. Flat sales growth forecast.
4. Without sales growth SBC would not be able to brew efficiently.

6. **What strategic alternatives did SBC have for increasing sales 5% annually, for several years in order to brew efficiently?**

A major challenge facing SBC was to grow 5% annually in an industry whose growth rate had declined to zero from dramatically high growth rates in the previous several years. At the same time the number of craft brewers had increased steadily as the industry had grown. There had been brewery closings, but the total number of breweries operating was at a record high level (see exhibits 1 & 2).

According to Ansoff's Growth Share Matrix there are four alternative strategies that a firm might use.

	<b>Current Products</b>	<b>New Products</b>
	Market	Product
<b>Current Markets</b>	Penetration Strategy	Development Strategy
	Market	
<b>New Markets</b>	Development Strategy	Diversification Strategy

SBC had been successful by deploying a brand line extension strategy from 1992-1997 as SBC introduced additional brews under the Shipyard brand. It did this in current markets and new markets as it expanded out of state into NY, NJ, MD, IL and GA. In 1998, however, it began dropping out of these very markets as sales growth in the craft beer industry continued to fall.

Since SBC had numerous brews to market, it can keep its product offering constant for the next year or two. What it must do is undertake a **Market Penetration Strategy** in Maine and New Hampshire immediately. The Maine and New Hampshire channel members were familiar with SBC, going back to the company's earlier stages of development. SBC must press hard with the promotional strategy it successfully used in 1994-96. That approach was to penetrate ME, NH and MA using personal selling and relationship building in a supportive way at retail outlets and with its distributors. SBC supported its channel members through point of sale merchandising materials, radio announcements of pub events that featured Shipyard, wait-staff training and incentives, community involvement and brewery tours.

As sales in its northern New England territory increase, SBC can then undertake a **Market Development Strategy**. This strategy would encompass the re-entry into Connecticut, Long Island, NY, New Jersey shore, Annapolis, MD. The sales approach should again be a "partnership" with channel members as SBC provides merchandising and media support to assure movement off the shelves of its

retailers. Distributors should be informed of SBC programs at the retail level so that they were stocked adequately for the volume SBC expected from any given territory.

SBC should also undertake a **Diversification Strategy** by actively pursuing contract-brewing business of brewers in the region. The diversification that I refer to is one of diversifying SBC's marketing approach from consumer sales targets to contract brewing sales targets. This approach should be undertaken immediately.

Reference: Keller, K.L. (2003). Building, Measuring, and Managing Brand Equity. 2<sup>nd</sup> ed. Upper Saddle River, NJ: Prentice Hall.

# Shipyard Brewing Company

# Product Sheet

<p>86 Newbury St. Portland, Maine (207) 761-0807 800-BREW-ALE www.shipyard.com</p>							
<b>MALT</b>	2-Row British Pale Ale, Crystal	2-Row British Pale Ale, Malted Wheat	2-Row British Pale Ale, Crystal & Malted Wheat	2-Row British Pale Ale, Crystal, Chocolate, Black & Roasted Barley	2-Row British Pale Ale, Crystal, Chocolate, & Roasted Barley	2-Row British Pale Ale, Crystal & Chocolate	2-Row British Pale Ale, Crystal & Chocolate
<b>HOPS</b>	Cascade, Willamette & Tettnang	Fuggles	Hallertau & Willamette	Warrior, Cascade, Tettnang & Goldings	Willamette, Cascade, & Tettnang	Cascade, Tettnang & Fuggles	Challenger, Progress & Goldings
<b>YEAST STRAIN</b>	Top-Fermenting English	Top-Fermenting English	Top-Fermenting English	Top-Fermenting English	Top-Fermenting English	Top-Fermenting English	Top-Fermenting English
<b>AVAILABILITY</b>	Year Round	Year Round	Year Round	Year Round	Year Round	Year Round	Year Round
<b>FLAVOR CHARACTERISTICS</b>	Malty with a hint of sweetness upfront & a dry hoppy finish	Smooth, dry & crisp flavor with floral aromas & apple-plum palate	Dry & crisp with smooth mellow malt & hop flavors 110 calories/12oz	Initial malt & caramel flavor with dry roasted finish	Smooth texture and mellowness, sweet finish, hint of chocolate & maple	Dry & crisp upfront with an aromatic hoppy finish	Hints of sweetness with fruit aromas, smooth texture, dry hoppy finish
<b>FOOD PAIRINGS</b>	Pork & chicken	Roasted chicken & grilled seafood	Shellfish, salads, and other light fare	Wonderful with desserts, especially anything chocolate	Traditional pub fare like hamburgers bangers & mash	Great with pork and pizza	Hearty casseroles, Lancashire hot pot pie
<b>COLOR</b>	Golden Copper	Light Copper	Light Golden	Jet Black	Brown	Copper	Light Copper
<b>AVAILABLE FORMATS</b>	12 oz Bottle, 22 oz Bottle, Keg	12 oz Bottle, Keg, Cask Conditioned	12 oz Bottle, Keg	12 oz Bottle, 22 oz Bottle, Keg	Captain's Collector, Keg	Captain's Collection, 22 oz Bottle, Keg	12 oz Bottle, 22 oz Bottle, Keg, Cask Conditioned
<b>FIRST BREWED</b>	June 1992	April 1997	April 2001	August 1993	April 1993	April 1995	October 1994
<b>OG</b>	1052	1055	1038	1052	1045	1050	1060
<b>A.L.C. % VOL./VOL.</b>	5.1%	5.8%	3.9%	4.7%	4.0%	4.9%	5.8%

86 Newbury St.  
Portland, Maine  
(207) 761-0807  
800-BREW-ALE  
www.shipyard.com



NOTES:

				
<b>MALT</b>	2-Row British Pale Ale, Munich & Malted Wheat	2-Row British Pale Ale, Munich, Malted Wheat, Caramalt & Crystal	2-Row British Pale Ale, Crystal, Chocolate & Roasted Barley	2-Row British Pale Ale, Crystal, Chocolate & Tortified Wheat
<b>HOPS</b>	Hallerau	Fuggles, Goldings, Tetnang, Mt. Hood, & Progress	Northern Brewer, Cascade, Tetnang, Goldings	Cascade, Tetnang, Fuggles & Goldings
<b>YEAST STRAIN</b>	Top-Fermenting English	Top-Fermenting English	Top-Fermenting English	Top-Fermenting English
<b>AVAILABILITY</b>	April - August	October - March	October - March	October - March
<b>FLAVOR CHARACTERISTICS</b>	Mellow malted wheat flavor with less hoppy characteristics	Complex Malt/Hop character, malty sweet upfront with a dry hop bite at the finish	Full-bodied, strong ale with a distinct roasted barley character	Rich malty ale with a hoppy finish
<b>FOOD PAIRINGS</b>	Great with seafood	Beef, pork & hearty dishes like stew	Hearty stick-to-ribs fare like steaks, steaks & kidney pie	Perfect with desserts or as a dessert in its self
<b>COLOR</b>	Golden	Coppery-Orange	Dark Brown	Deep Amber
<b>AVAILABLE FORMATS</b>	12 oz Bottle, Keg	12 oz Bottle, Keg	Captain's Collection, 22 oz Bottle, Keg	12 oz Bottle, 22 oz Bottle, Keg
<b>FIRST BREWED</b>	June 1995	September 2000	October 1995	December 1993
<b>OG</b>	1050	1058	1062	1070
<b>ALC.%VOL./VOL.</b>	4.8%	5.2%	5.8%	6.7%



## **SONY Online Entertainment: EverQuest or EverCrack?**

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*Presented at the REGULAR session of the Case Association 2004 Meeting*

Keywords: online gaming, social responsibility, addiction

### **ABSTRACT**

SONY Online Entertainment (SOE) was planning to release a new version, EverQuest II®, of its popular online game, EverQuest®. The first EverQuest® game was very successful financially, generating approximately \$5 million/month in 2002 for SOE. However, some issues surrounding addictions and corporate responsibility were interfering with the new product launch. These problems revolved around several deaths in which the EverQuest® game had been implicated. The case focuses on the dilemma faced by the Vice President of Marketing prior to the new product release: How far must a company go to protect possible misuse of a product by consumers?

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Scott McDaniel<sup>145</sup>, Vice President of Marketing for Sony Online Entertainment (SOE), walked wearily into his office and shut the door. He had just come from an executive board meeting in which the President of SOE, John Smedley<sup>146</sup>, had disclosed to him a recent development involving the online computer game, EverQuest®,<sup>147</sup> manufactured and heavily promoted by SOE.

### **The Incident**

At around 6:00 a.m., on Tuesday, November 20, 2001, in Hudson, WI, Shawn Woolley had logged on to his computer and began playing EverQuest®, his favorite game. A few hours later he committed suicide. Two days passed and, when he didn't show up for Thanksgiving

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<sup>145</sup> Scott McDaniel Biography. Retrieved May 1, 2003, from [http://www.sonyonline.com/corp/company\\_info/bios.jsp](http://www.sonyonline.com/corp/company_info/bios.jsp)

<sup>146</sup> John Smedley Biography. Retrieved May 1, 2003 from [http://www.sonyonline.com/corp/company\\_info/bios.jsp](http://www.sonyonline.com/corp/company_info/bios.jsp)

<sup>147</sup> EverQuest® – You're In Our World Now! (Home page for EverQuest®). (n.d.). Retrieved May 1, 2003 from <http://everquest.station.sony.com>

dinner, his mother, Liz Woolley, found his body in a rocking chair at his computer desk. He had a .22 caliber rifle at his side and EverQuest® was still playing on his computer screen.<sup>148</sup>

Mrs. Woolley stated to the news media that she believed the cause of Shawn's suicide was his addiction to EverQuest®.<sup>149</sup> The news media picked up on the suicide story and the potential issues of addiction, obsession, or compulsion of today's consumer for online game-playing at the expense of their daily lives. Although the media contacted Sony Online Entertainment for comment, the only response from the company was from Mr. McDaniel, stating "There's a duty on the consumer to use it responsibly."<sup>150</sup>

### **Shawn Woolley**

Shawn Woolley, a 21 year old shy, slightly overweight young man, had been diagnosed with depression in conjunction with schizoid personality behavior. He also had a history of seizures. Shawn had been living in a group home for a short time, but checked himself out after several months and rented his own apartment. He had held a variety of different jobs over the preceding year, but he quit his last job about a week before the suicide.<sup>151</sup>

Shawn began playing EverQuest® approximately one year before his death. When he committed suicide, he left no note. The only clues for what he had been doing prior to his suicide were notes about names and terms related to EverQuest®. His family claimed that the lure of the game for Shawn was the camaraderie with other players. Mrs. Woolley related one

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<sup>148</sup> Irvine, M. (2002, May 26). Online game blamed for son's suicide. *Lexington Herald Leader*, p. A5.

<sup>149</sup> Miller, S., (2002, March 30) Death of a game addict. *Milwaukee Journal Sentinel*. Retrieved May 1, 2003 from <http://www.jsoline.com/news/State/mar02/31536.asp>

<sup>150</sup> Irvine, M. (2002, May 26). Online game blamed for son's suicide. *Lexington Herald Leader*, p. A5.

<sup>151</sup> Patrizio, A. (2002, April 3). Did Game Play Role in Suicide?. *Wired News*. Retrieved May 1, 2003 from <http://www.wired.com/news/games/0,2101,51490,00.html>

incident in which Shawn cried because another player had stolen some of the treasures he had collected playing the game.<sup>152</sup>

### **EverQuest® - The Game**

Emblazoned across the EverQuest® web-site were the words, “Pause Life. Play Game.” EverQuest® was a “real 3D massively multiplayer (MMP) fantasy game role playing game (RPG).” A massively multiplayer online game is a video game where a player connects through the Internet to a persistent virtual world, joining with hundreds of thousands of other gamers in a shared experience. In a role playing game, there is no “winning” in the traditional sense. Players create their own characters which are then “free” to roam the fantasy world.

The scope of EverQuest® differed from player to player. EverQuest® players entered into an enormous virtual entertainment world named Norrath, with its own species, economic systems, alliances, and politics. The players could wander around seeking allies and knowledge, facing epic challenges, meeting new friends, and more.

Each player defined his/her own character’s destiny. The character could be a knight, a misshapen elf, a dwarf, a monster, or a damsel in distress. Characters grew in strength and in power based on the total number of hours they were played. EverQuest® players usually attempted to form “guilds” or teams which worked together to earn points, slay monsters, and capture key positions within the world of Norrath. A monetary value was attached to the characters as they became recognized “rulers” in Norrath. One player who reached the highest EverQuest® levels reported selling three characters on e-bay for \$4,500.<sup>153</sup>

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<sup>152</sup> Irvine, M. (2002, May 26). Online game blamed for son’s suicide. *Lexington Herald Leader*, p. A5.

<sup>153</sup> Scheeres, Julia. (2001, December 5). The Quest to End Game Addiction. *Wired News*. Retrieved May 1, 2003 from <http://www.wired.com/news/holidays/0,1882,48479,00.html>

Pressure for players to continue playing the game and not logging off was tremendous. Logging off could hurt the guild's chances of advancing through the game since strength in numbers was critical for attacking a dragon or another guild, or trying to steal the treasures of another character. In addition, logging off could allow your character be attacked because, even though a player was not online, their character remained in play and actively involved in the land of Norrath.

### **Financial Implications**

Introduced by Sony Online Entertainment in 1998, EverQuest® retailed for approximately \$40. It required either a Sony Playstation game system (\$199.00) or could be played on a personal computer. For an additional \$12.95 per month, players could sign up to play the game online. Revenues from online subscriptions netted Sony approximately \$5 million a month.<sup>154</sup>

The game and its expansions were widely popular. One expansion of the EverQuest®, game, “The Shadow of Luclin”, sold 120,000 copies on the day it was released. As of May 2003, there were approximately 430,000 registered players of EverQuest®, with approximately 12,000 more signing up each month.<sup>155</sup> On any given night, approximately 100,000 players roamed the world of Norrath.<sup>156</sup> Since Norrath existed online, the players were from around the world, increasing the likelihood that play would be intense even when most of America was sleeping. Indeed, demand in Europe for this game became so great that in November 2001, Sony had to construct and bring online a new server dedicated to EverQuest®.<sup>157</sup>

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<sup>154</sup> Keighley, Geoff. (2002, August). The Sorcerer of Sony. *Business 2.0*, 49-53.

<sup>155</sup> Keighley, Geoff. (2002, August). The Sorcerer of Sony. *Business 2.0*, 49-53.

<sup>156</sup> EverQuest Or EverCrack. (2002, May 28). *CBS News.com*. Retrieved May 1, 2003 from <http://cbsnews.com>

<sup>157</sup> Press Release. [www.sonyonline.com/corp/press.jsp](http://www.sonyonline.com/corp/press.jsp). October 29, 2001.

More than 1,000 computers kept the game running, with forty-seven Sony staffers continually adding items and quests to the game and approximately 128 “game masters” functioning online wandering around in Norrath answering questions.<sup>158</sup> Because the game became so popular, Norrath was likely to become overpopulated. To combat this, Sony launched 42 versions of the game so that players could relocate their character to different “world” for a \$50 fee.<sup>159</sup> The revenue stream was so good that Sony planned to introduce EverQuest® II, a project costing \$20 million.<sup>160</sup>

### **Online Addiction**

Numerous mental health organizations are dedicated to dealing with online addiction.<sup>161</sup> Experts believe that online gaming is a significant addiction problem, causing a growing number of people spending huge chunks of time at the computer. Some psychologists believe that this particular game is so addictive in nature that it should be called “EverCrack”.<sup>162</sup> The peer pressure to stay online and help your guild, the lure of playing anonymously, and the thrill of the hunt, make EverQuest® very appealing to consumers.

Mrs. Woolley developed her own website in her quest to educate people about the dangers of playing Everquest®.<sup>163</sup> Two additional web-sites appeared for EverQuest® “widows,” dedicated to providing a support group for those individuals dealing with a husband,

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<sup>158</sup> Keighley, Geoff. (2002, August). The Sorcerer of Sony. *Business 2.0*, 49-53.

<sup>159</sup> Keighley, Geoff. (2002, August). The Sorcerer of Sony. *Business 2.0*, 49-53.

<sup>160</sup> Keighley, Geoff. (2002, August). The Sorcerer of Sony. *Business 2.0*, 49-53.

<sup>161</sup> Media Family.org – Media Influence on children: Making Media Manageable for Families and Children (Home page for Media and Family). (n.d.). Retrieved May 1, 2003 from <http://www.mediafamily.org> and see Internet/Computer Addiction Services (Home page for Computer Addiction Services). (n.d.). Retrieved May 1, 2003 from <http://www.icaservices.com>

<sup>162</sup> Miller, S., (2002, March 30) Death of a game addict. *Milwaukee Journal Sentinel*. Retrieved May 1, 2003 from <http://www.jsonline.com/news/State/mar02/31536.asp>

<sup>163</sup> Online Gamers Anonymous. (Home page for Online Gamers Anonymous). (n.d.). Retrieved May 1, 2003 from <http://www.olganon.org>

wife, girlfriend, son, etc. addicted to playing the game. An active web-site with links to numerous online addiction services, “EQ Widows” listed 3,654 members.<sup>164</sup> A similar web-site provided opportunities for aggrieved family members to vent their anger about the game and receive moral support.<sup>165</sup> One member stated that her fiancé “picked the game over me on Mother’s Day. He picks the game over when I have my family from out of town.”<sup>166</sup> Other members responded with advice and encouragement, including one member who opined that she should “move on... There is no reason for you to suffer when there are other men out there in the real world that you can date.”<sup>167</sup>

In one survey, 45.2% of the 1,989 respondents considered themselves addicted to EverQuest®. The typical player logged more than 20 hours per week playing the game,<sup>168</sup> with one survey estimating that 15% of the users played between 40-50 hours per week.<sup>169</sup> Another survey of 3,166 players indicated that for the 18-22 year old age group, 50.7% of the males and 44.7% of the females have lost sleep over their playing habits.<sup>170</sup>

However, some psychologists believe that the online gaming is not addictive. Instead, they say, the personality of the particular player is what puts him or her at risk. Shawn Woolley’s diagnosed personality disorders made it easy for him to reinvent himself on line, which is what he appeared to do. This “escape from reality” feature of the game could be very

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<sup>164</sup> Yahoo! Groups: EverQuest Widows (Home page for EverQuest Widows). (n.d.). Retrieved May 1, 2003 from <http://groups.yahoo.com/group/EverQuest-Widows/>

<sup>165</sup> Yahoo! Groups: Spouses against EverQuest. (Home page for Spouses against EverQuest). (n.d.). Retrieved May 1, 2003 from <http://groups.yahoo.com/group/spousesagainsteverquest>

<sup>166</sup> Yahoo! Groups: Spouses Against EverQuest. (2003, May 30). Message Board - Message 407. Retrieved June 21, 2003 from <http://groups.yahoo.com/group/spousesagainsteverquest>

<sup>167</sup> Yahoo! Groups: Spouses Against EverQuest. (2003, May 30) Message Board – Message 407. Retrieved June 21, 2003 from <http://groups.yahoo.com/group/spousesagainsteverquest>

<sup>168</sup> Everquest Or Evercrack. (2002, May 28). *CBS News.com*. Retrieved May 1, 2003 from <http://cbsnews.com>

<sup>169</sup> Yee, N. (2001). The Norrathian Scrolls: A Study of EverQuest. Retrieved May 1, 2003 from <http://www.nickyee.com/eqt/report.html>

<sup>170</sup> Yee, N. (2002). Ariadne – Understanding MMORPG Addiction. Retrieved May 1, 2003 from <http://www.shinyspinning.com/weblog/archives/00000036.html>

alluring to individuals with low self esteem. The thrill of anonymity may have lured Shawn and other players to continue playing and playing and playing....

### **Future of SOE and online gaming**

SOE planned to introduce EverQuest II® in the fall of 2003. Destined to be as popular as EverQuest®, the new version would be set in a new age – the Age of Destiny. Players' quests would directly affect the structure of the game, thus changing the plot line on a monthly basis. SOE was anticipating high profits and favorable customer response with this new product.

But, SOE had some possible legal issues looming. Mrs. Woolley was contemplating filing a lawsuit against Sony Online Entertainment for its alleged role in her son's suicide. Some time after January 2003, a warning label appeared on EverQuest®'s web-site: "Photosensitive. Seizure Warning". In addition, in Tampa, FL, the EverQuest® game was implicated in the death of a young child when the father threw the child into a closet after the child's crying had interrupted his game playing.<sup>171</sup>

Scott McDaniel paced his office and thought about the planned release of EverQuestII®. As big a money-maker as it promised to be, was SOE justified in releasing it? Was the game really responsible, even in part, for death, abuse, or other personal emotional damage to players? McDaniel himself had a family. Was there something he should be doing besides preparing the ad campaign?

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<sup>171</sup>Becker, D. (2002, April 12). When games stop being fun. *CNET News.com*. Retrieved May 1, 2003 from <http://news.com.com/2102-1040-881673.html>

### **Case Synopsis**

SONY Online Entertainment (SOE) was planning to release a new version, EverQuest II®, of its popular online game, EverQuest®. The first EverQuest® game was very successful financially, generating approximately \$5 million/month in 2002 for SOE. However, some issues surrounding addictions and corporate responsibility were interfering with the new product launch. These problems revolved around several deaths in which the EverQuest® game had been implicated. The case focuses on the dilemma faced by the Vice President of Marketing prior to the new product release: How far must a company go to protect possible misuse of a product by consumers?

### **Learning Objectives**

1. Develop investigative skills by examining the conflict between corporate and personal responsibility.
2. Analyze the competing issues of online addiction and addictive personalities with protection against restraint of trade.
3. Consider various options for marketing strategies for EverQuest II®.
4. Evaluate the public relations ramifications of the negative publicity generated due to specific incidents versus the positive publicity generated due to the public popularity of the game.

### **Courses and Levels of Students**



This case was written for use by undergraduate students in a business program. Specifically, the case was utilized as the focal point for an Ethics Awareness Week. It can be used readily in the undergraduate or graduate classroom in connection with issues of consumer law, business ethics, electronic addiction, and organizational behavior.

For the topic of corporate versus personal responsibility it connects well with Chapter 2, “Ethics and Social Responsibility.” Chapter 11, “Product Advertising and Liability,” works for a discussion of the legal ramifications of the decision, in Jennings, *Business: Its Legal, Ethical, and Global Environment*, 6<sup>th</sup> Ed. In management classes, the case works with Chapter 16, “Leadership”, in Daft, *Management*, 6<sup>th</sup> Ed. In marketing classes, the case fits comfortably in a discussion of societal marketing concept, a philosophy held by some academicians that true social responsibility means developing or marketing only products that are to society’s betterment. A discussion on this theory and this case fit well with Chapter 1, “Developing Customer Relationships and Value through Marketing” as well as Chapter 4, “Ethics and Social Responsibility in Marketing” in Kerin, Berkowitz, Hartley, and Rudelius, *Marketing*, 7<sup>th</sup> Ed. Administrative communication classes utilized this case in lower level business communication class in conjunction with Chapter 1, “Communicating in the Workplace”, in Lesiker and Flatley, *Basic Business Communication*, as well as in upper level managerial reporting writing courses, in Chapter 1, “Establishing a Framework for Business Communication”, in Lenhan and Dufrene, *Business Communication*.

### **Discussion Questions**

1. After having met its legal obligations for product safety, what further obligations might SOE have?

2. What obligations does a company have to protect consumers from their own decisions?
3. How far should the company have to go to protect an adult person who is willingly playing a game?
4. Why are lawsuits against the entertainment industry so difficult to win?
5. In light of the documented evidence regarding the hours the average user plays EverQuest®, should the company be required to place any form of warning label on the product?

### **Analysis**

In our litigious society, it appears that consumers are beginning to believe that there are no consequences for their own actions. From cases involving McDonalds and a person's "addiction" to fast foods being the cause of their obesity to this case involving an "addiction" to an online game being the cause of a suicide, society appears to be trying to redirect blame from the person to the corporation.

However, lawsuits involving theories of product liability negligence design or insufficient warnings can only be successful if the elements of the tort are established. Problems occur in defining the legal duty owed and the breach of such duty because the corporation would contend that the product was designed, manufactured, and sold in compliance with standards set forth by the industry. Causation is another stumbling block for a successful lawsuit. In order for causation to be established, the consumer must prove that the damage (suicide) was actually caused by the game. Since the issue of online addiction is so new, there has not even been a pronouncement from the American Psychological Association that online gaming is an addiction. Foreseeability also is difficult to establish: what is the probability that a person will become addicted to an online game and commit suicide because of the game? Consequently, even if the

elements of a product liability negligence action are established, the corporation may argue that the online gamer assumed the risk when he/she chose to play and, thus, the corporation should not have liability.

In addition to the legal issues raised by this case, the corporation must also deal with the mounting concern of bad publicity and possible accompanying loss of profits. No business wants to be labeled as the entity that blissfully ignores the frailties of the public and feeds on their weaknesses. Conversely, the primary purpose of a corporation is to maximize shareholder wealth. This product has been very profitable for the corporation and could conceivably be even more profitable with the projected launch of EverQuest II®. Thus, how do these two seemingly diametrically opposed viewpoints converge into a successful marketing plan for this product?

If the purpose of a corporation is to maximize shareholder wealth, then Sony Online Entertainment is achieving its purpose. Profits from game purchases and monthly subscription fees as well as monies generated from the associated products and fan conventions are continuing to rise. Even if a lawsuit is filed by Mrs. Woolley contending that SOE is responsible for her son's suicide and she is successful in the lawsuit, the cost of the lawsuit as well as the damages awarded may be less than the cost of the recall of the product and/or a decision to stop producing the product.

If the purpose of a corporation is to maximize shareholder wealth by serving society as a whole, then, according to Mrs. Woolley, SOE is not achieving this goal. Should a corporation continue to produce and market a product that has been linked to a suicide? This question begs the alternative question – should SOE stop producing a product that hundreds of thousands of customers enjoy since one person committed suicide? Which goal is SOE committed to pursue?

### Discussion Question Answers (A quality and C quality)

The EverQuest® case has been tested in various classes with various assignments. One of the projects involved a paper presenting the basic question of corporate versus personal responsibility. This project was in the Legal and Ethical Environments of Business class, a sophomore level class. Students enrolled in this class typically have completed most, if not all, of their business core and general education requirements, e.g., accounting, economics, English, and mathematics. In addition, a number of the students were enrolled in the upper division administrative communication class during the semester that this particular project was used.

### Suggested Abbreviated Answers to Discussion Questions

“C” Quality Answer	“A” Quality Answer
<p>1. After having met its legal obligations for product safety, what further obligations might SOE have?</p>	
<p>Define, without example, corporate responsibility and personal responsibility</p>	<p>Using examples and secondary sources (articles, cases, etc.), explain the terms personal and corporate responsibility.</p> <p>Using role models such as social responsibility, golden rule, etc. to explain the terms.</p>
<p>2. What obligations does a company have to protect consumers from their own decisions?</p>	
<p>Mention product liability in terms of a</p>	<p>Using cases similar to Ford Pinto, Tylenol,</p>

<p>concept rather than in terms of a concept applied to this particular case.</p>	<p>MacDonalds, etc., review the area of product liability, particularly the area of foreseeability.</p>
<p>3. How far should the company have to go to protect an adult person who is willingly playing a game?</p>	
<p>Acknowledgement that negative publicity exist but does not recognize the long term ramifications of this situation.</p>	<p>The decision to continue to produce this product in view of negative publicity can have significant long term ramifications for the company. Compare and contrast various businesses that have struggled with continued viability after a negative publicity event (e.g. Firestone Tires, Ford Explorer, Exxon, United Carbide)</p>
<p>4. Why are lawsuits against the entertainment industry so difficult to win?</p>	
<p>Focus on the short term financial gain.</p>	<p>Examine the financial ramifications of this decision to continue to market the product and to bring out an expanded game. Comparing the monies generated by the product to the potential loss of monies if a lawsuit occurs, what would be the better short term/long term decision?</p>
<p>5. In light of the documented evidence regarding the hours the average user plays</p>	

EverQuest®, should the company be required to place any form of warning label on the product?	
Discuss and dismiss this argument. It is a game and games can simply be turned off.	.Explore the “addictive” nature of online gaming. Considering the American Psychology Association cannot agree on whether or not this is a recognized addiction, should (or could) a company be held liable for an online gamer’s addiction and ultimate death?

**Teaching Suggestions**

This case was utilized by a variety of different disciplines in a myriad of ways. The College of Business and Technology (Eastern Kentucky University) used this case as the focus of the Ethics Awareness Week (EAW). For the EAW, some professors utilized this case as the starting point in the semester for a discussion regarding ethics and social responsibility while other professors utilized this case from the beginning of the semester and culminated the discussion of the case during the EAW.

Examples of how the case was utilized include:

- a major research paper in the business law/ethics class
- an assignment regarding societal marketing responsibility in a marketing class
- an in-class assignment in finance regarding financial ramifications of the decision

- several assignments preparing press releases and other communications from the corporate office in administrative communication classes
- a discussion regarding the online addiction issue in a public relations class
- in-class discussion and assignment focusing on the leadership styles of SOE management in a management class
- in-class assignment reviewing and comparing the debater's arguments from the Oxford style debate in a management class
- an assignment regarding continued marketability of the product for a marketing retail class.

In addition, this case was the subject of an Oxford style debate sponsored by the College of Business and Technology. Two debaters presented the diametrically opposed viewpoints of corporate responsibility and personal responsibility. There was an opportunity after the debate for student interaction/questions. Student attendance was mandated in some classes, and suggested in others. Evaluations of the debate established that it was a very well received pedagogical method for highlighting ethics and social responsibility. The debate was repeated at the 10 Annual International Conference Promoting Business Ethics (Garden City, NY) in October 2004.

### **Epilogue**

During the course of the writing of this case and subsequent Ethics Awareness Week, the popular TV show, 48 Hours, showed a segment on the issue of online gaming and this particular game, EverQuest®. Highlighted on that show was an interview with Mrs. Woolley, Shawn's mother. Copies of this show are available for purchase through the television station.

Attempts were made by the author Spain to talk to Mrs. Woolley about this case but to no avail. Several months after the EAW, Mrs. Woolley called author Spain. Since Shawn's suicide, Mrs. Woolley periodically searches the internet for articles, documents, newspaper stories, etc. about EverQuest® and issues of online gaming. Woolley and Spain had several conversations about this game, her son, and her concerns about online addiction.

Mrs. Woolley presented a very compelling argument that SOE should be held responsible for its actions and should be required to change the nature of the game to make it less addictive. In addition, Mrs. Woolley is a tireless advocate that online gaming should be listed as an addiction and, thus, individuals with this addiction can more easily seek professional help.

One of the items that Mrs. Woolley focused upon, as an indication of the addictive nature of this game, was the inordinate amount of time that gamers play EverQuest®. Interestingly, SOE altered the game after Shawn's death to include an option for a time clock to notify gamers that the predetermined time that the gamer set has now been reached. SOE has also made some other changes to the game. The banner emblazoned across the web-site home page for EverQuest® used to state "Pause Life, Play Game". That statement has now been removed. The game also now contains a warning label regarding epileptics and the possible effects of this game upon a person with that type of disability.



## Specialized Finance Group #1

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*Presented at the REGULAR session of the Case Association 2004 Meeting*

Keywords: Leadership Motivation Culture Teamwork Budgeting Planning Power

### ABSTRACT

The protagonist is a senior dealmaker, recently promoted to significant line management position in an investment banking product area where he has “bottom line” earnings responsibility. His resources consist of a team of varied, but dissatisfied and demoralized professionals. In the context of that environment, students must decide: How should he determine the amount of revenue he will commit to produce the following year and what is that amount? How should he organize and motivate his new team? How should he define his role as their leader and manager and upon which activities should he focus his time and energy?

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It was a Friday in early October as Elliott Hafar settled into his business class seat over the Atlantic, heading back to New York from London. He reminded himself, “Be careful what you wish for, because you might get it.” After years working doing deals for investment banks and complaining about the managers, he was now one of “them.” Winston Nackered, the newly appointed London-based Global Head of MultiBank’s Specialized Finance Group (“SFG”) had just made him responsible for all of SFG’s origination activities in the Americas. That is, he now managed six professionals who were responsible for marketing and delivering SFG’s products to MultiBank’s corporate customers who operated from Canada to Argentina. More importantly in the “MultiBank world,” he now had a bottom line responsibility; he had to sign up for, and meet or beat, an earnings budget for the following year.

Elliott was no under no illusions that he had gotten the job because people thought he had special managerial abilities. He had a law degree from Cornell, and over fifteen years experience in a variety of investment banks, the last three at MultiBank. During his career, the most people he managed was exactly one, usually a relatively inexperienced if hardworking and ambitious

person with an MBA from a top school. Elliott knew he had reputation for making his juniors work long hours, showing scant regard for their feelings or personal concerns, closely supervising their work, and being impatient and critical of their mistakes or failings. Most of the people who had worked for him had admitted they had learned a lot that would help them in their careers but were grateful when they could move on to another position. He had spent his last two years at SFG working with one such assistant on a deal that Luke Michaels (the former head of SFG's US operations) had thought was a waste of time. Despite Michaels' misgivings and a lack of support from others in SFG, Elliott had persevered and was about to reap the rewards. He was finalizing negotiations with one of MultiBank's German corporate customers for a \$1 billion transaction using the structure that Elliott had developed. Once the paperwork was signed, that deal alone would contribute \$6 million to SFG's earnings (and Elliott's group's budget) over the next year alone. As was typical for SFG's deals, Elliott had had to work closely with other parts of MultiBank to get the deal done and each of those product areas also made money off the transaction; in this case, they earned an additional \$6 million off the transaction. At times, negotiating with other parts of MultiBank was as difficult and important as negotiating with the customer and outside investors. Elliott knew that, as was customary in the bank, he had gotten the promotion for his deal-making abilities, not his managerial talents. He knew that management was as much of a skill as structuring deals, and he knew that it was important to make sure his first experience, as a manager was successful.

### The Questions

He had three immediate concerns. First, he needed to think about how he should spend his time and energy as a manager. Second, he was meeting with his new group Monday morning and he wanted to lay out his vision for how SFG "Americas" would be run. Third, he had to come up

with an earnings budget number for his group that he was willing to commit to for the following year.

### The Business

MultiBank's corporate banking activities were divided primarily into two broad areas. One consisted of customer groups which were composed of "relationship bankers" who were responsible for managing MultiBank's relationships with its key corporate customers, mostly large US and foreign-based multinationals and coordinating the sale of MultiBank's vast array of services and products, everything from traditional bank accounts to sophisticated capital markets products. The second consisted of product groups that actually 'produced' and delivered the products. SFG was a product group and its professionals were designated as "transactors," emphasizing their focus on "transacting deals" with whichever corporate account they could persuade to hire them. SFG was one of the product areas that provided advisory services to the corporate customers for a fee. SFG would use its 'know-how' to design large, complex and tailor-made transactions for customers, usually to help them meet tax or accounting objectives and then place these deals with investors in the marketplace. . Transactions ranged in amount from \$100 million to \$1 billion and would usually take from six to twelve months to complete from when the customer hired them. SFG had about ten primary competitors in the business, although SFG had the broadest product capability and was most global in its reach, and was ranked first or second in most of the product segments in which it competed. It had over sixty professionals around the world and the prior year had made \$40 million in fees. While the dominant in its market niche, SFG was a relatively minor player within MultiBank's investment banking group, contributing relatively modest, but stable, earnings.

In Winston's mind (and Elliott's) \$40 million was not that impressive given the rule of thumb that a business of that type ought to be able to earn \$1 million per person. Additionally, given MultiBank's tremendous size, a business had to earn at least \$100 million to be considered as anything other than a minor sideshow. Winston had made it clear he had no desire to run a mere "sideshow" and he wanted to grow the business quickly and substantially. Winston had reorganized SFG into five business groups, including Elliott's (see Exhibit 1- Simplified Organizational Chart). The manager of each of these business groups had to sign up for a revenue target for the coming year. Winston in turn would "roll" these up and present the total to his boss as SFG's revenue target.

### His People

Which brought Elliott back to his immediate problem. He had inherited all six people who were now working for him. He knew their morale was low. Everyone (including Elliott) had previously reported directly to Luke Michaels. Michaels' had largely ignored them and concentrated on doing his own deals (in fact, some had seen a memo in which he had claimed credit for deals they had worked on). He had believed in specialization and gave each person an independent and narrowly defined product or geographic responsibility. People complained about being kept in 'silos' and getting no support. Winston had fired Michaels and decided to reorganize, splitting up some of the US functions between those who dealt with investors and those who dealt with the corporate customers (Elliott's new group). Even though they had worked in the same group on the same floor, Elliott had had almost no contact with these people and had known little about them. He had been trying to quickly do his homework.

The six people who now formed SFG Americas had made only about \$750,000 that year – which made Elliott groan. Two of them, Conrad Nolan and Jerry Taylor, were responsible for most of that as they were responsible for one specific accounting oriented product: the Off-Balance Sheet Debt Instrument or OSDI. The OSDI had been a very innovative produce when MultiBank had introduced it to the market a decade before but now the financial technology had been disseminated in the market and many banks were offering similar products. As a result, the amount SFG could charge for a ‘plain vanilla’ version of the product was low. Conrad was very hard working, staying late alone in his office every night pouring over legal documents. The relationship bankers were very complimentary of him. SFG had made \$600,000 in advisory fees from the OSDI. Conrad boasted that other parts of MultiBank that worked with him on deals that he structured had earned ten times that much. Jerry had just been hired from the New York branch of a Japanese bank and was still trying to make his way and get to know relationship bankers. Conrad had been too busy with his own deals to help Jerry settle in. Elliott knew that Jerry had originally come to MultiBank with one of his colleagues – his colleague had lasted a week at SFG before deciding he had made a mistake and had negotiated a return to his previous employer. Elliott had just learned that Jerry had considerable experience in a much broader array of products than OSDI.

Daniel Pillus’s background was another surprise. He had been brought into SFG the prior year from a MultiBank office in Miami to develop or adapt products to be sold to corporate customers in Latin America. Pillus had worked hard pursuing every lead but the investment had still not paid off. Pillus had always been referred to as the “Latin American guy” and Elliott had been surprised to learn he had been at MultiBank for ten years, was well known and respected by

a large number of relationship managers, and had previously worked in London for one of MultiBank's competitors doing European transactions.

Elliott saw the same pattern everywhere. Simon Graham was working out of MultiBank's Toronto office, responsible for developing Canadian business. Elliott did not know Simon very well, but knew that he was the equivalent of a CPA and was known as hard worker in Toronto. While he had not made money with MultiBank's Canadian customers, neither had MultiBank's competitors. And then there was Marcus Sussman. Which brought up yet another headache: the merger. The prior year MultiBank had merged with another financial institution. That institution had a very small group with some products that seemed to overlap with SFG's. Marcus had transferred over to SFG from that group, and brought a few promising customer contracts with him. Like Jerry, he was struggling to orient himself in his new environment. The problem was with Marcus' prior group. They continued to act as if they too could offer advisory services for products that had been exclusively the domain of SFG. Elliott knew that this was a normal part of the post-merger process and that there would be political battles ahead if SFG was to protect its turf.

Elliott continued to tick off the abilities of his new team. They all seemed to have been working in isolation in their isolated silos. And they seemed to have skills or abilities that were not being used.

### The Culture

Elliott was aware that SFG had a very strong culture. There were few long time employees. One reason was that SFG was committed to providing innovative 'value added' products that took advantage of opportunities that might appear. Whenever a product became a

“commodity” that could be offered at a lower cost by MultiBank’s competitors, SFG would move on and create a new product. This strategy often caused them to hire in people with the necessary skills rather than grow them internally. The ‘typical’ SFG person had a graduate or professional degree (MBA’s, JD’s, and CPA’s abounded) and had been with SFG for only about four years. Elliott’s new team’s average tenure in SFG was even shorter. While there were a few young MBA’s recently out of MultiBank’s management training program, most of the transactors had been in the business for many years and were on average in their 40’s. Many had known each other from “previous lives” when they had worked together or as competitors in other firms.

Elliott knew the SFG culture was primarily utilitarian in nature. People joined and stayed out of self-interest. There were no written contracts; the underlying psychological contract was that people would contribute to SFG hard work, expertise, and long hours and SFG would provide them with the support they needed to do creative deals. In exchange, if they were successful they expected to be paid large bonuses. The base salary for the more experience ranged from \$125,000-150,000 but a very successful deal-maker could make two to three times his or her base salary (given their relatively poor individual performance, Elliott knew most of his new team members were unhappily resigned to receiving bonuses that were nominal in amount and below what their more successful colleagues in SFG would be earning). The culture valued innovation and individual performance. People were highly competitive and the social norms allowed, even encouraged, people to be aggressive in their interactions in order to get the job done. Given the complexity and dynamic nature of the business, there were few formal rules and for the most part people were free to choose what transactions they wanted to work on, and

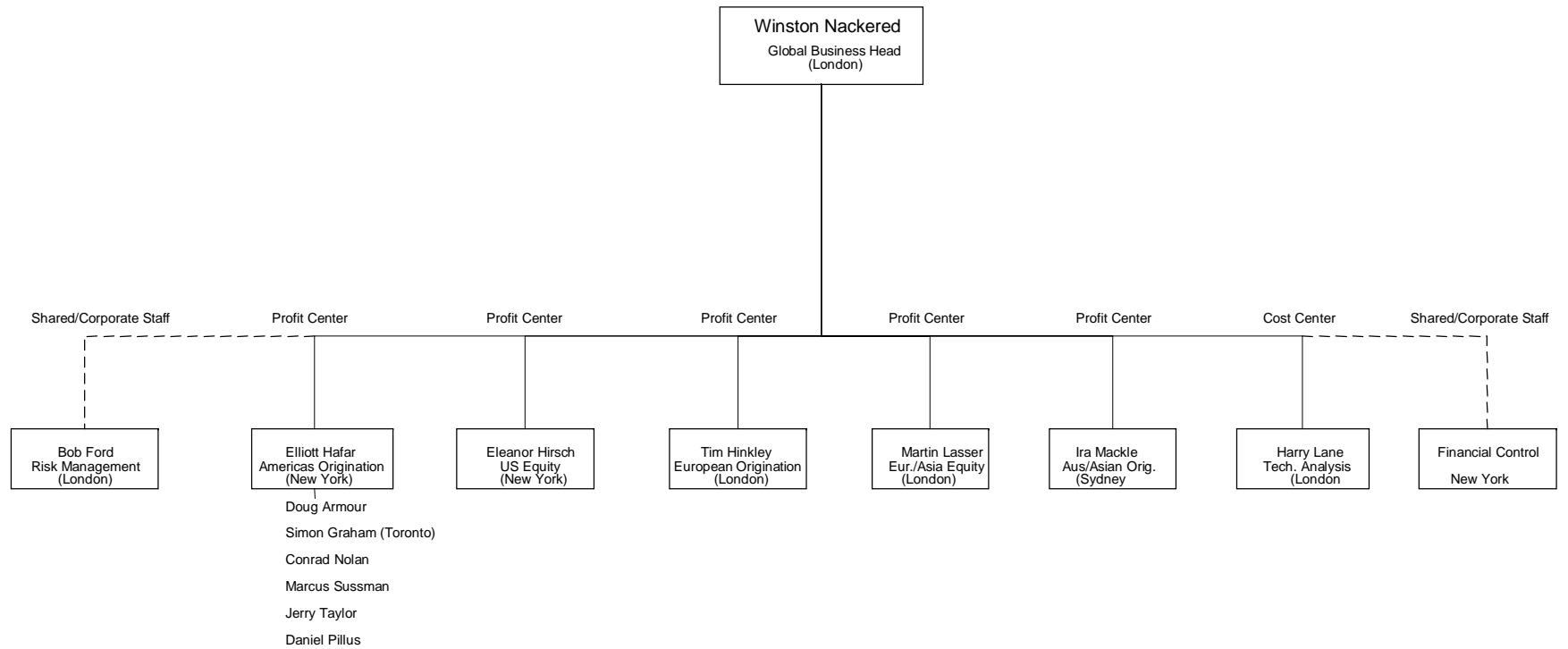
who they wanted to work with (both in terms of other SFG members, MultiBank relationship managers, and customers). Michaels especially believed in letting people pursue the opportunities that they saw as most promising, while reminding them that they would bear the price if they chose poorly of receiving no bonus (Elliott's bonuses were nominal during the period he was developing his new product). Still, it was that attitude that allowed Elliott to dedicate his time and resources to his pet project that was going to pay off so well in the coming year.

As the 767 flew westward, Elliot continued to grapple with the three main issues. He knew he had to show up on Monday and set the course for the following year. He had been an extremely successful transactor, now he had to see if he could be equally successful as a manager.



Exhibit 1  
Simplified Organizational Chart  
Year 1

# Specialized Finance Group



Home location of person or majority of headcount in subgroup in parentheses

## *SFG #1 – The Epilogue*

Elliott had identified three primary and inter-related questions he had to answer quickly.

His first step in any deal was to define for himself what his customers wanted. In his manager role, he considered his primary customers to be internal: his boss and his subordinates. Given the corporate culture and setting, he thought it was straightforward. His own boss, Winston Nackered, was ambitious and wanted to transform a relatively minor, if profitable, group that generated \$40 million annually in revenues into a larger and significant group that would serve as a spring-board for his further advancement. In light of a recent merger, both Nackered and Elliott thought that unless you brought in at least a \$100 million annually, your business was merely a circus side-show. As Nackered wanted to be in the main ring, he had a “\$100 million problem” which he would want to solve in no more than two years. Nackered would want SFG to earn at least \$60 million in the following year.

SFG had been divided into five ‘businesses,’ each with its own revenue target. In theory, SFG’s (and MultiBank’s) overall revenue budget was developed “bottom up” with each business unit first determining how much it could contribute and then submitting it to Nackered for consolidation. In reality, MultiBank’s Chairman promised shareholders strong year-to-year revenue growth and the pressure flowed from the top down to business managers to commit to deliver ever-increasing earnings. Nackered would pressure his five business managers to commit to deliver \$60 million. Elliott also knew that expectations regarding his group were very

low, both because it was new group with no 'base level' and because its members, as individuals, were among the worst performing in SFG.

Elliott knew his people were unhappy and dissatisfied. In an environment where bonuses of good performers could be two or three times their base salary (which averaged \$125,000) he knew they were getting nominal, even shameful by industry standards, bonuses. They were mostly in their 30's and 40's, had MBA's or other professional degrees, and were used to being successful. One of the reasons they had come to work for SFG and MultiBank was its reputation for doing cutting-edge, complex and innovative deals. He knew most of his people (if not all) were highly competitive, achievement oriented and – very frustrated.

### **The Number**

Elliott wrote down four numbers on a notepad: \$1,500,000, \$6,000,000, \$12,000,000, and \$15,000,000. The amount he committed was important in many ways. One, it sent a message about his confidence in his own abilities as a manager and leader. Two, SFG's structure and processes were organic and non-bureaucratic and decisions made and resources allocated through a fundamentally political process. Unless he demonstrated his intention and ability to make a significant contribution to SFG's goals, he would not have a meaningful claim for resources and support. Three, Nackered would be extremely displeased with Elliott (or any other manager) who failed to deliver the promised earnings – there was a personal cost to falling short. Four, if he vastly exceeded his target, Nackered and others might discount it as luck, not skill so there was also a personal cost to excessively overshooting.

He circled \$12 million. \$1,500,000 was doubling the revenues but the \$750,000 base was so low that thinking in those percentage terms was ludicrous. The \$6 million was in line with the rule of thumb and safe. But that figure, from Elliott's perspective, would send the message that he, as a manager, thought he could only deliver "average" performance. Which was not the message he wanted to give anyone. And he thought contributing only 10% to Nackered's "\$60 million problem" would make him at best a marginal player within SFG and with limited negotiating strength or legitimate claim on resources and support. Using an analogy with large family holiday gatherings, Elliott had thought to himself, "I have to sign up for at least 20% of Nackered's \$60 million goal if I want to sit at the adult table."

If \$12 million was the "right answer," it was also sixteen times what those same individuals had produced the prior year and 30% of SFG's current year budget. Elliott knew that he first had to convince himself, and then his team, that they could pull it off.

## **The Meeting**

Elliott had known the first meeting with his new team was going to be crucial. He viewed their low spirits as providing him with an opportunity. He was going to propose a radical change in how they worked. They were intelligent, experienced, and cynical – he had decided he was going to be up-front and honest with them (except, he was going to keep any of his own doubts about his plans well hidden).

He had arranged for the group to meet in a conference room in another floor of the MultiBank building and told them to block out the afternoon for it. He told them he was going to start with the revenue target. He had carefully laid out his analysis, written the four numbers on the whiteboard and then crossed out all but the \$12,000,000, adding “but I am pretty sure we can make substantially more.” And then he had stopped, and looked at his bankers, trying to guess which would be the first to speak. They were staring at him incredulously. Finally, Daniel Pillus, leaned back in his chair and asked, “Elliott, are you always delusional or are you on drugs?”

Which gave Elliott the opening he had expected. “Look, I can show you we can do it. But only if you all buy into it. If you look me in the eye and tell me you’re in, then they will be backing the Brink’s truck into your driveways to deliver your bonuses next year. If you don’t, then you keep doing what you have been doing for last couple of years.” He stopped and waited. “Ok, let’s hear it,” Marcus Sussman said.

“We make \$12 million only if we work as a team. You’re talented as individuals but you’ve been forced to work in silos. So, for example, Pillus was hired to do Latin America and I have seen work like a dog on the highest potential deal he could see in that market. Working on a deal with a 9% probability of success is better than working on a deal with a 8% probability but we, as a group, have the entire Western Hemisphere to do business. A narrow product orientation in the US and a geographic focus in Canada and South America make no sense. I want to create two teams and divide the Hemisphere up by customers and industries. Second, everyone in SFG work as individuals, as cowboys. I can’t do anything about that – yet. I know we can only be successfully if we can create new products quickly and that can only if we work

together. So as far as I am concerned, we can only make \$12 million if we work like a team. It doesn't do me any good if one of you brings in \$2 million and no one else brings in anything. Nackered is only going to give me a large bonus pool to allocate among you guys if we meet our target. I understand not each of you can make \$2 million," he nodded towards the youngest member who was recently out of the training program, "and we can come up with individual targets. But as part of a team, either we are all successful and all get paid a lot of money or we all fail and no one gets paid."

He waited a minute, let it sink in. "You all know about the ATP deal? That is the billion dollar deal that I spent the last two years working on. We're finalizing documentation and it will bring in SFG \$6 million in cash next year. As you know, we run a 'cash business' when it comes to determining bonuses – no 'accrued' income or expected earnings count. If you buy into the team concept, I will contribute that \$6 million to the pool. That means I too will be paid a bonus by Nackered only if we all bring in an additional \$6 million." He stopped a second. "If you guys don't buy into a team concept and want to go back to the old way, I can go to Winston now and say, 'I am going to bring in \$6 million on my own deal next year and want to be paid for that outside of management role so no matter what else my team does, you still have to pay me.' The point is I want to be viewed, and paid, as a successful manager, not as a transactor and am willing to put the ATP deal into our collective target if you are all willing to work with me."

Pillus asked skeptically, "So what make you think Nackered will pay us even if we do bring in the money?"

“Because we are going to be a group. We are going to be cohesive. They may screw over an individual but if we make that money they know they can’t screw us all over. If we produce and they don’t reward us, then I’ll lead you out the door to another bank that will pay us what we deserve. Look, this is a group of individuals who work alone – there is power in numbers and cohesion. If we act like a group we are more powerful than the any individuals. Which means we have to project unity. Which means, for example, we can fight among ourselves – I expect us to – but to the outside world we’re solid. Jerry, you can call Marcus an idiot when the door is closed, but to the outside world he is the best banker you’ve ever met. You denigrate him, you weaken us, and you hurt yourself.”

Sussman asked, “So, Elliott, what are you going to do? Even with your \$6 million from ATP, we have fill bringing another \$6 million. Are you going to be the super transactor? Are we here just to do the grunt work and provide support?”

“No, I see my job is to protect our interests with the outside world. I’ll help with deals when there is something I can do to add value but I am not going to be a transactor. That is your job. Look, Conrad made \$600,000 working like a dog on six deals on which the rest of the bank made \$6 million. We can’t work that cheaply. I had a 50-50% split on the ATP deal. We shouldn’t get out of bed in the morning for \$100,000. We can make another \$3 million without changing the way we do business at all. We need sharp elbows to grab what is ours. You guys have to fight for it but I am going to be fighting with resources, and policies, that you will let you guys do more business and make more money at it. And it is my job to make sure that each and every person in this team works hard and smart as a member of the team.”

The meeting then progressed into the discussion of people's concerns and needs and what they thought they would need if they really were going to sign up for what still seemed to be an impossibly ambitious target.

### **The Results - *The Wolf Pack***

With wariness and varying degrees of confidence and commitment, everyone signed into Elliott's vision. At the end of the next meeting, Elliott ended it with, "OK, we need a name. The official name is SFG Americas Origination. But we need another name. What is it?"

There were lots of discussion and finally Jerry, said, "The Wolf Pack. Because wolves hunt in packs, feast on their prey together, and howl at the moon to celebrate their victories. And that is what we have to do. And that is the image we have to project." And the Wolf Pack was formed. Elliott was amazed that such a group of hard-bitten professionals embraced the concept. They created rituals (everyone was given a wolf-themed nick-name in a special 'naming ceremony), hunting terminology infiltrated their memos, and they all wore golf shirts and caps with wolves embroidered on them to off-sites. Elliott's office was filled with wolf-themed paraphernalia that people brought back from trips.

The Wolf Pack had made \$14 million that first year. The success did not come easily. Elliott had instituted a system where all the Wolf Pack members met weekly to review individual deals. Individuals who were accustomed to choosing what leads they wanted to pursue were



finding they had to defend and justify their choices as the collective goal gave everyone a legitimate voice. The team stormed and while it presented a united front to the outside world, the strong personalities led to frequent confrontations. Two of original Wolf Pack members, Conrad and Simon, proved themselves unable or unwilling to work outside of their original silos and Elliott and the Wolf Pack had purged them (in each case through arranging transfers to other MultiBank units) and replacements had been hired from competitors. People worked long hours and traveled constantly. Elliott had spent much of his time negotiating within SFG and with other parts of MultiBank to get the resources and the share of revenues that the team needed. As both Elliott and his people negotiated hard with other parts of SFG and MultiBank (as well as customers) for the maximum amount of revenues to be taken into their profit center, they had earned a reputation for being aggressive and confrontational. Nonetheless, revenue and head count grew over the next three years:

**America's Origination: Wolf Pack Growth;**

	Headcount	Revenue	Per Person
Year 1 (including ATP)	7	\$14 million	\$2.0 million
Year 1 (excluding. ATP)	6	8 million	1.3 million
Year 2	12	22 million	1.8 million
Year 3	13	29 million	2.2 million

*Year 1 (including ATP): official group contribution and headcount for SFG. Year 1 (excluding ATP): earnings for incremental revenue contribution by headcount not involved in ATP deal.*

SFG itself had grown during the three years both through its own revenue growth as well as absorbing other product areas that had existed within MultiBank. SFG total revenues had reached \$120 million. Nackered his achieved his objective of SFG becoming an important revenue center and had corresponding internal political influence.

*But now Elliott worried that success had spawned a new set of problems he had to address...*

## CASE TEACHING NOTES (SFG #1)

- Case Title: Specialized Finance Group (SFG #1)
- Status: Advanced Developmental (used in one undergraduate and one graduate class)
- Courses: Management, Organizational Behavior, Organization Theory
- Student Level: Undergraduate and graduate.
- Topics:
- Leadership
  - Motivation
  - Organizational and Cultural Intervention
  - Managing teams
  - Budgeting and Planning
  - Power

### Abstract

The protagonist is a senior dealmaker, recently promoted to significant line management position in an investment banking product area where he has “bottom line” earnings responsibility. His resources consist of a team of varied, but dissatisfied and demoralized professionals. In the context of that environment, students must decide: How should he determine the amount of revenue he will commit to produce the following year and what is that amount? How should he organize and motivate his new team? How should he define his role as their leader and manager and upon which activities should he focus his time and energy?

### Learning Objectives:

Improve student understandings of

- The differing roles and functions of a manager and leader and the situational factors that may both determine and limit them.
- The content of various leadership theories (Ohio State, Michigan, Fiedler, Hersey and Blanchard, path-goal, transformational, charismatic, etc.) by trying to apply them to guide Elliott.
- Challenges of motivating employees to work as interdependent team members rather than as individuals.
- Conditions under which individuals and organizations may be receptive to changes in practices.
- Rationales and limitations in budgeting, planning, and control in a dynamic environment.
- Determinants of individual and departmental power in an organizational setting and actions that might be taken to achieve power.

Possible Supplemental Readings (graduate or undergraduate):

Gabarro, J.I., & Kotter, J.P. (1980). Managing your boss. *Harvard Business Review*, 58, 92-100.

Kanter, R.M. (1979 ). Power failure in management circuits. *Harvard Business Review*, 57, 65-75.

Kotter, J.P. (1982). What effective general managers really do. *Harvard Business Review*, 60, 156-167.

Kotter, J.P. (1990). What Leaders Really Do. *Harvard Business Review*, 68, 103-111.

Mintzberg, H. (1975). The manager's job: folklore and fact. *Harvard Business Review*, 53, 49-61.

Mintzberg, H. (1985). The organization as political arena. *Journal of Management Studies*, 22, 133-154.

Pfeffer, J. (1992). Understanding power in organizations. *California Management Review*, 39, 29-50.

Pfeffer, J., & Salancik, G.R. (1974). Organizational decision making as a political process: The case of a university budget. *Administrative Science Quarterly*, 19, 136-151.

Salancik, G.R. (1977). Who gets power – And how they hold on to it: A strategic-contingency model of power. *Organizational Dynamics*, 5, 3-21.

### Background and Research Methods

The author spent several decades working in commercial and investment banks before starting a doctoral program as a first step in a second career. His last position was as a Vice President and Senior Transactor in a group within the Investment Banking Division of a major multinational financial services company that developed and executed large structured financings for corporate customers. The data collection for the case is the result of participant observation, but as a “lived experience.” The text of the case was subsequently reviewed and discussed with the manager upon whose experience the case was developed.

### Instructor Questions

Beyond the general questions, the following specific questions may also facilitate discussion. They are provided in the order I think the discussion of the case naturally flows rather than by theme or subject. Obviously, the dynamic of a case discussion will vary by class and instructor.

**Epilogue:** The epilogue may be distributed after the students discuss the case as an example of one response. It has the advantages and disadvantages of verisimilitude. To the extent it represents what “really happened” and led to a successful outcome (by some measures, at least) students may tend to accept as being the “right” answer. As one reviewer suggested, I have ordered the questions within the text so that the revenue commitment question is the last to be considered. However, although ignorant of the academic resource dependency theory, Elliott was highly aware of importance of he (and his group) being perceived as bringing resources (revenues) into the organization on his (and his group’s) power, influence, and remuneration. He is equally aware that his own boss has a similar view of the basis of organizational decision-making and politics. As a result, the revenue number was the first he addressed. Assignment of the Pfeffer and Salancik readings may be

relevant if the epilogue is provided. Also, the instructor may ask whether, as long as the decisions were consistent, it made any difference in what order they were posed.

A follow up case may address some medium term problems related to Elliott's strategy: family problems and divorces (including his own) and burn-out among SFG professionals. Elliott may need to decide whether he and SFG have a problem, and if so, what can be done about within the constraints of their business..

**What do Elliott, his boss, and his employees really want?** Students tend to answer in terms of what (from my perspective) are the intermediate goals (increase revenues, improve the groups visibility and prestige within the organization, etc.,) rather than their ultimate goals or 'valences' (personal prestige, personal power, and personal monetary reward). As I believe Elliott's actions and decisions would be heavily influenced by the amount of personal ambition, I think it is important to discuss and highlight his ultimate goals rather than the intermediate goals that he may believe would enable them to achieve them.

**Elliott has to decide how much to tell his boss he can earn, organize and motivate his employees, and define his roles and priorities as their leader. In what order should he tackle these issues? Does the order make any difference? Are they so interrelated that they have to be decided simultaneously?**

**We have discussed a variety of leadership theories, models, and behaviors. If Elliott came to you and asked what theory he should read about and apply to this situation, what would**

**you tell him?** Elliott ends up adapting a role that appears more consistent with path-goal theory, focusing, his attention of ensuring that his people have the resources and support they need to to their jobs and receive the rewards for it.

**If Elliott were named as a manager of a troubled factory, one of his first actions would likely be to evaluate the condition and the suitability of the production equipment. In this case, his “productive assets” are his people. How would you assess them in terms of their knowledge, motivation, and capabilities?**

**If these people that Elliott has inherited have been unsuccessful in the past, why doesn't he just fire them and bring in better people?**

**Elliott is the only one of these people who has proven he can do big deals and make a lot of money. Why shouldn't he focus his energies on acting as a super senior deal maker, bringing in the team as necessary to support his deals, and otherwise letting them continue to work individually as they have before? Given his own demonstrated ability to identify and close deals and his teams apparent inability to do so when left alone, should Elliott reduce their autonomy and as leader tell them what deals they should work on rather than trusting them to make the right decision?**

**Describe the organizational environment in which Elliott's team and SFG operate. What implications do that have on the roles and priorities that Elliott should have as leader?**

**Elliott's group, the industry, and his people seem to be highly individualistic and used to working autonomously. Do the conditions exist for Elliott to try to transform the way they work? If Elliott wants them to work as a team rather than as individuals, how does he motivate them? If they are accustomed to receiving bonuses based only on their individual efforts, can he implement a bonus system that would recognize and reward team efforts and orientation? Can he impose such a system? If he cannot impose it, can he persuade them to embrace it? How might Elliott's priorities as leader be different if his people try to work more as an interdependent team rather than as autonomous and independent individuals?**

**Conrad is the only one who has actually made some money. Do you think Conrad is one of his most valuable people for that reason? Does Conrad's value depend on whether Elliott wants to continue to promote individualistic effort or whether he wants to develop a team-orientation?**



**Elliott has to commit to his boss to deliver a revenue number for the following year. Under the prior manager, his people made a total of only \$750,000 the prior year. Remembering that there is a strong downside to missing the target, how much should Elliott tell his boss that he and his people will contribute the following year? Why? What do you think his boss's reaction would be to that figure? How much influence and power within the Group would Elliott have if that was the figure? How would Elliott be recognized and rewarded if he delivered that figure? What would happen if he missed the target? What would happen if he greatly exceeded the target?**

**Remember Elliott's deal is likely to bring \$6 million into SFG the following year. How does that impact on the revenue target he should submit? How might he treat this revenue vis-à-vis the relationship with his team and how he organizes and motivates them?**

**When Elliott did his deal, he made \$ 6 million and the rest of the bank made \$6 million. On the other hand, when Conrad did his deals, he made only \$600,000 and the rest of the bank made \$6 million. How might this information affect Elliott's decision with respect to setting his revenue target for the following year? How might it affect what roles he should prioritize as manager?**

## **Suspended between a Rock and a Hard Place: Launching IT Interactions in Time and Space in an Emerging Global Business**

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*Presented at the REGULAR session of the Case Association 2004 Meeting*

Keywords: Advanced Collaborative Technology, Global Business, Team Exercise

### **ABSTRACT**

Suspended between a Rock and a Hard Place is a dramatic and entertaining team exercise for developing 21st century global business expertise. Its purpose is to facilitate discussion and develop competencies in leaping from working primarily face to face to suddenly needing to collaborate electronically in a geographically distributed work environment. This futures scenario is grounded in recent organizational research on multi-media advanced collaborative technologies with international managers and professional staff in multinationals. The target groups for this pedagogical tool are MBA's in international business courses and middle managers in executive education programs in emerging global businesses. Instructor's guide included.

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*Suspended between a Rock and a Hard Place: Launching IT Interactions in Time and Space in an Emerging Global Business*, applies as a pedagogical tool for classroom discussion, a futures scenario grounded in research conducted by the author on advanced collaborative technologies in 21<sup>st</sup> century global business activities. The research upon which this case is written is based upon multiple sources including document analysis, interviews with corporations and participant observations in virtual communities consisting of organizational researchers as well as managers using collaborative technologies for global business activities. *Suspended between a Rock and a Hard Place* is intended to be used as a teaching instrument in introductory courses in international business in domestic oriented MBA programs in the United States. *Suspended between a Rock and a Hard Place* is also intended to be used in executive education programs for middle management in emerging global businesses.

A dramatic and entertaining team exercise is used to facilitate discussion among students of how to make a leap from working primarily face to face to suddenly needing to collaborate electronically in a geographically distributed work environment. Moreover, quotes are provided from a company that has been able to make a rapid leap to using a sophisticated collaborative technology in a relatively painless and productive manner, *Utopia* [pseudo name]. This case is intended to illustrate an approach to adopting virtual work practices in an emerging global corporation as more than a "necessary evil".

Attached is the instructor's version of the case intended for practioners who are late adopters of advanced collaborative technology. This case challenges the traditional perspective that face to face communication is necessarily better than electronic communication among geographically dispersed participants. In the instructor's note, a model of e-engagement is presented to ameliorate the possibility of participants to prepare to work in a high functioning

manner on a sophisticated virtual platform, like Interwise, in an emerging global business. The audience for this case executive education participants who are middle managers.

The appendices contain a plethora of materials to help the students to effectively implement the case. These include: Ranking of Virtual Team Startup Resources by Panel of Experts ((Richter and Willett, 2002, pp. 20), links Interwise, the advanced collaborative technology platform to be used in this pedagogical case, and a successful case of an application of product design using Interwise in the Utopia [pseudo name] corporation. Additional materials will be added at a later date.

## **2. Pedagogical Case Study—Instructor’s Version**

**December 15, 2003**

Oh no! Your boss has just given you until the end of the year to put together a geographically dispersed team to develop and present a web conference on computer mediated work practices for the entire HR group worldwide in your firm that just went public. Despite the major cutback in business travel since 911 and the SARS epidemic, your company has continued to support travel for face to face meetings on a regular basis.

Aside from this deadline, you never took the time to learn the collaborative technology that you will be required to give this internationally disseminated web cast on.

As you begin to plan your strategy, you wish that you had spent more time in headquarters in recent months so you could have anticipated this change. However, its time for action now and its too late to fret.

As you sit at your desk in Ohio overlooking the Allegheny River, the bare branches are grey and bleak in the park that you can just faintly see from your 26 floor office. You are alone in the office as your colleagues are all out traveling until the office holiday party on December 23. You start to read over the shocking e-mail that arrived from your boss in Las Vegas at the headquarters this morning. You see that these monumental tasks have been broken down into allegedly manageable tasks. The expectations for you are to:

1. Have the skeleton of a group developed by year that can help you led the collaborative technology initiative at your company.
2. Have your team sufficiently on board and up to speed to include them in your web cast scheduled for early January 2004.
3. During the web cast, to present the collaborative technology that your company just switched to without consulting you
4. To lead geographically distributed team that you are now going to be heading up, with a “can do” and “follow me” attitude.
5. There will not be a budget for this project until at least the first quarter of the new year and because this project barely skid by board approval, you are to show a return on the investment in the software before there will be a travel budget

You are six months pregnant, tired and not enthusiastic about an additional challenge before year end. Nonetheless, you schedule the worldwide web conference for January 4, 2004 at 10 AM standard time. That will mean your boss will need to be online at 7 but your collaborators in Europe will be able to first have almost a few work day (but still get out of the office in time for their holiday parties.

As you gaze out the window, you try to think through every intricacy of this project. Even though you report to the Director of IT, you know that your company has not highly progressive in staying up to speed with the latest collaborative technologies and that you are probably more capable of learning quicker than he is in your stogy institution that has always placed the utmost value on “high touch” and face to face meetings.

Not only do you have little time to act but the last thing you want to be doing with your antiquated skills, is looking for a new job with a new baby in hand. As you give yourself a

pep talk, you realize that you are going to have to rely on the best of all your friends and colleagues to make this project a success.

Suddenly, a huge FedEx package arrives for you. As you tear open the envelope, you see an index of documents which includes:

- A CD on how to host a web conference on the Interwise software
- A well researched list of 10 key resources (Richter and Willett, 2002, p. 20) for crises like the one you are facing listed in no particular order among other proposed resources. These include:
  1. A map of the geographical distribution of your company
  2. Names and addresses of five people outside your company who are highly accomplished in the use of modern information systems and who also have strong team skills
  3. E-mail [could their possibly be anyone in the organization who isn't online yet?]
  4. Expertise in creating and presenting web-based seminars
  5. High speed internet connections for all team members
  6. Online meeting capability including whiteboard, application sharing, and instant messaging [you are informed that the Interwise software that you are to use has all the features]
  7. A strong basis for trust and respect among potential team members across cultures
  8. Knowledge of your company's past projects and current business focus

9. Names and addresses of colleagues in your organization who are already adept at meeting on virtual work platforms
10. Web portals that allow shared folders, e-mail exchanges, and collaboration on documents both synchronously and asynchronously
11. Shared understanding of work practices using the latest advanced collaborative technologies
12. A box of Swiss chocolates
13. An erasable pen
14. A high speed scanner
15. Outsourced technical support from a partner of the software provider

#### **4. Student Tasks**

Your first task is to learn how to use the software... You start by flipping through the hundreds of pages that arrived in the FedEx envelope...

You find.....a glossary of terms, and the guidelines under which your group is supposed to reach consensus in getting the this advanced collaborative initiative off the ground at your company[to be added].... You also find a list describing and ranking high to low context cultures (Hall, 1969), a list describing and ranking the ten researched resources listed above (appendix A), the Interwise web address, a user's guide to the software and data collected about the successful and recent pilot application of the Interwise software at a Danish consumer products company, Utopia [pseudo name]. You start to organize the materials into a document that the entire team can use during the start up phase of the advanced collaborative technology project at your organization. In doing so, your 1<sup>st</sup> objective is to get a winning team on board and up to speed.

You are expected to keep track of the steps involved to organize the this web presentation and to evaluate the degree to which the resources above were drawn upon and just how valuable you found them to be....In January you are told you will be expected to write a company wide guide to using the Interwise collaborative technology for geographically distributed meetings and learning sessions.

## **Appendix A**

### **Ranking of Virtual Team Startup Resources by Panel of Experts**

(Richter and Willett, 2002, pp. 20).

**1. A strong basis for trust and respect among potential team members across cultures.**

Not only are trust and respect listed as the most important resources for a start up virtual team by Richter and Willett (2002, p. 18 & 20) but by numerous leading information system and management experts (Handy, 1995, Lewick & Bunker, 1996; Snow, Snell & Davison, 1996; Ishaya and Macaulay, 2000).

**2. Names and e-mail addresses of five people outside your organization who are experienced in both using advanced collaborative technologies and who have strong team skills.** According to Richter and Willett's team of experts (2002, pp 18-21) this is the key to success in seeing the criteria to use to identify and link geographically and organizationally dispersed people who are able to work together without the convenience of meeting face to face.

- 3. Names and e-mail addresses of five people outside your company who are highly accomplished in the use of modern information systems and who also have strong team skills.** Richter and Willett's team of 10 collaborative technology experts ranked the rapid ability to connect with these IT experts and understand what it takes to become one of them as the first major step towards assembling a team that is quickly able to come up to speed working solely through a virtual work platform.
- 4. Online meeting capability including whiteboard, application sharing, and instant messaging [you are informed that the Interwise software that you are to use has all the features].** This has been provided integral to the Interwise software. Richter and Willett's experts ranked this as critical. Specifically, those authors mention that the lack of these capabilities would most likely impair your ability to conduct an effective web meeting.
- 5. Expertise in creating and presenting web-based seminars.** For the deadline driven demand like yours, the Richter and Willett's experts agree that someone needs to already have the hands on skills for a start up team to shine.
- 6. Shared understanding of collaborative virtual work practices.** According to Richter and Willett's IT experts, this is defined as "the abilities to generate and refine ideas, to organize and integrate work, to sustain team esprit, and to manage boundaries between people effectively—all via technology" (2002, p. 19). Like in the instance of #5 above,



expertise in creating and presenting web-based seminars, a very effective facilitator can help the group overcome this limitation in the short terms.

**7. Web portals that allow shared folders, e-mail exchanges, and collaboration on documents both synchronously and asynchronously.** Richter and Willett's experts stress that this is important but these functionalities are integrated into the Interwise software. The key point here is being able to use the web portal efficiently and effectively.

**8. Knowledge of your company's past projects and current business focus**

I concur with Richter and Willett's panel of experts that this is a fundamental requirement and that the lack of it is a major obstacle. Again, this information can come from other team members rather than you independently.

**9. High speed connection to the Internet for all team members.** The Interwise software does not require a high speed connection although most people who use it regularly find it somewhat defeats the purpose of time management without a high speed connection. Richter and Willett's experts also agree that while a high speed internet connection is unessential, when every minute counts it can make the difference between being able to deliver or not.

**10. E-mail.** Even though the team will need some form of asynchronous tool to disseminate information in geographically and time distributed activities, Richter and Willett's

experts agreed that e-mail by itself without a complete package of advanced collaborative technology will impede the team's ability to deliver. I am in agreement with the experts take on this as well as "the team will need to develop protocols for how they use this tool in order to avoid "info-glut" (Richter and Willett, p.14).

*Note, the other resources mentioned have not been ranked by the panel of experts.*

## **Appendix B**

Interwise web site and user guide

The Interwise web address, [www.Interwise.com](http://www.Interwise.com)

A user's guide to the software is available on line at the Interwise web site

## **APPENDIX C**

### **Documentation of Utopia's [pseudo name]" Success Using Interwise in Geographically Distributed Product Design**

Utopia [pseudo name] is test piloting Interwise, enterprise collaborative technology in product design between Denmark and the United Kingdom. Excerpts of email-s from Utopia (head of Interwise collaborative technology project) to the researcher during October and November, 2003 are presented below and then followed by the question to which the email responds.

*We are presently using the voice over, application sharing, white board & drawing tools. We wish to also use web cams too but we are not*

*set-up to do this due to our software limitations (NT). We will run a trial  
soon...*

The above quote responds to the question: **What functions are you using of the Interwise virtual platform to conduct your work (voice over, application sharing, white board, drawing, archives..)?**

*We hold various virtual meetings discussing all types of design work. For example - drawings, CAD images, story boards, models, functions etc. Interwise is most useful when holding a meeting with someone (max 4 people) over long distance where this meeting requires supporting visual design work that need to be discussed in detail.*

The quote above responds to the researcher's question:

**What tasks do you perform on the Interwise virtual platform?**

*It definitely makes it easier and saves us money & time not having to travel to do the same task previously. Hugely beneficial! We often used to travel to Denmark from UK to do some of the above tasks.*

The quote above responds to the researcher's question

**How do you find the Interwise virtual platform either makes it easier or more difficult for you to perform these tasks with your colleagues based elsewhere in the world?**

*Sharing (communication) of design ideas within a project team. Our information tends to be very visual due to the nature of product design.*

The above quote responds to the researcher's question: **What parts of your job do you feel you can accomplish on the virtual platform? [Interwise]**

*Group brainstorming and meetings that require you to demonstrate something physically where you have to touch and feel it.*

The quote above responds to the researcher's question: **What parts of your job do you feel you need to conduct face to face?**

**Additional comments from Utopia about using Interwise for collaborating between geographically distributed product designers**

*Good points...*

- *It's a fantastic product that saves our company a lot of money. (Less travel required)*
- *It enables us to resolve problems over distance*
- *People can be easily trained anywhere!*

*- It has a simple interface to interact with (could still be improved thought...)*

*It definitely makes it easier and saves us money & time not having to travel to do the same task previously. Hugely beneficial! We often used to travel to Denmark from UK to do some of the above tasks. [the ones now done on Interwise—product design, status meetings, meetings with vendors]*

***Bad points...***

*- Be patient in a meeting... You have to take your time and as the bandwidth can often slow the flow of information.*

*- Lack of Web-Cam*

*- Not good if you have more than 5 people taking part in the meeting. (as information flow becomes slow and less productive)*

*Eli*

**Description of a typical interaction over Interwise at Utopia**

*"After the people involved on the design team exchange quick greetings on the Interwise virtual platform, we start exchanging proposed design improvements. This is done by using the markup/drawing feature on top of the whiteboard (particularly the functionality of our modeling software) in application sharing. This enables me to show the team what I have made in terms of a new or revised design. By sharing the application with the team members who are based*

*thousands of miles away and hours of time distance apart, all of the team members are able to comment on my drawing and give my immediate suggestions for improving. The Interwise platform makes working with colleagues based elsewhere in the world much easier. It would be impossible to work in this way by phone and collaborating on the Interwise virtual platform is more effective than video conference for the design process. Technical details can be discussed in a rich manner and gatherings with last minute scheduling can be accomplished for situations needing sudden and immediate attention."*

### **A Success Story of Interwise Startup at Utopia**

Utopia [pseudo name] is a household name that is beloved by children and adults alike throughout the world. Eight thousand people are employed by Utopia worldwide. It is a major consumer product company and is headquartered in Scandinavia. Utopia starting piloting the Interwise software a number of months ago particularly for product design collaboration, problem solving with vendors and status meetings.

Interwise is an Israeli enterprise wide advanced collaborative technology platform with 5 distinct functionalities including virtual meetings and virtual learning programs. The platform facilitates applications sharing, whiteboard, chat, and voice over. Web cam is an option but it is not used at Utopia.

The following document was produced as an in-house corporate communications document at Utopia on November 11, 2003 and was sent by e-mail to the author:

## Meetings on your PC save time and money – for those who use it

*“Meetings on your PC, virtual meetings, save time and money and they reduce the risk of misunderstandings. That is, for those who want to and dare take advantage of the possibility. That is the conclusion so far as [Utopia] Company for some months has been testing the tool Interwise in a pilot project. With Interwise employees can have virtual meetings – each person at his own PC, anywhere in the world, and for instance discuss certain [Utopia] elements or molding forms. Drawings or pictures can be turned on the screen and you are able to point the mouse to indicate where the problem is. Everyone wears a head-set and can talk to each other... **With the Interwise tool you are able to point the mouse to specific details on an image online.***

*Mechanical engineers in Denmark, and designers in England, are working together on a brand new line of products. This is the first project that has had Interwise as a tool right from the beginning but it can, of course, be used by everybody who needs to share information across borders.*

Design Manager James H. in England likes the fact that unforeseen problems can be solved immediately: *“You can gather anyone, anywhere around the world, providing they can hook up to the Internet. You do not have to organize a video conference and you do not have to leave your desk from where your information is based. You can even save the meeting on your PC to go back to as a reference. We have saved four trips from the UK to Denmark in the last 8 weeks.”*

James H. is convinced that a global company such as the [Utopia] Company must have access to the tool as it makes communication across the borders easier, it is convenient to use and it saves money. James H. says: *“We would be silly not to use it.”* In Denmark, Jørgen H. works as a mechanical engineer, and he needs to share his work with designers in England. He says: *“The tool is absolutely indispensable when you work with designers somewhere else. I have been to England once since the beginning of August – usually one or two of us would have gone once or twice. You can also add the fact that our project is further ahead than we normally would have been. With the use of virtual meetings we can go through seven-eight elements in a couple of hours – normally we would have spent a whole day including the traveling.”*

*“But of course you still need to be talk face to face every once in a while. Every project reaches some mile stones where you have to be in the same room with all the elements and discuss different solutions.”*

According to Jørgen H., Interwise is a bit more complicated than booking a meeting through Outlook and James H. also has a few objections:

*”It is reliant on the Internet speed and speech or pictures can become slow at times. You have to familiarize yourself with the interface and learn to use it right, but the more you do it, the easier*

*it gets.*” James H. finds that large groups of people can make meetings rather slow, if everyone has to be heard, and his team thinks keeping numbers below five is ideal. Eli S. is, together with Søren B. H. from Global IT, project leader at Interwise and he has had a lot of positive feedback from the users.

Says Eli S.:

*“They thought it was difficult but tell us they find it easy to use. To some extent it has been difficult to get people to use the tool, especially for projects already running. It is a bit like when we first started using the video conferences – people thought it was kind of weird. Employees are extremely busy and therefore not very likely to use a new tool – you do it the way you have been used to.”*

He [Eli S.] emphasizes how necessary it is to actually know the people you work with *“But if we ever get a new SARS situation it is important to be better prepared.”* When SARS raged in the beginning of 2003 the [Utopia] Company chose to advise against all travel to and from Hong Kong, China and later also Canada.



## Teaching Note

### 1. Abstract

*Suspended between a Rock and a Hard Place: Launching IT Interactions in Time and Space in an Emerging Global Business*, applies as a pedagogical tool for classroom discussion, a futures scenario grounded in research conducted by the author on advanced collaborative technologies in 21<sup>st</sup> century global business activities. The research upon which this case is written is based upon multiple sources including document analysis, interviews with corporations and participant observations in virtual communities consisting of organizational researchers as well as managers using collaborative technologies for global business activities. *Suspended between a Rock and a Hard Place* is intended to be used as a teaching instrument in introductory courses in international business in domestic oriented MBA programs in the United States. *Suspended between a Rock and a Hard Place* is also intended to be used in executive education programs for middle management in emerging global businesses.

A dramatic and entertaining team exercise is used to facilitate discussion among students of how to make a leap from working primarily face to face to suddenly needing to collaborate electronically in a geographically distributed work environment. Moreover, quotes are provided from a company that has been able to make a rapid leap to using a sophisticated collaborative technology in a relatively painless and productive manner, *Utopia* [pseudo name]. This case is intended to illustrate an approach to working with advanced collaborative technology that is more than a “necessary evil”.

Attached is the instructor’s version of the case intended for practioners who are late adopters of advanced collaborative technology. This case provides an opportunity to debate the traditional perspective that face to face communication is necessarily better than electronic communication among geographically dispersed participants. In the instructor’s note, a model of e-engagement is presented to ameliorate participant’s competencies in preparing to work in a high functioning manner on a sophisticated virtual platform, like Interwise, in an emerging global business. The audience for this case executive education participants who are middle managers.

The appendices contain a plethora of materials to help the students to effectively implement the case. These include: Ranking of Virtual Team Startup Resources by Panel of Experts (Richter and Willett, 2002, pp. 20), the link to Interwise, the advanced collaborative technology platform to be used in this pedagogical case, and a successful case of an application of product design using Interwise in the [Utopia] corporation. Additional materials will be added at a later date.

### 2. Teaching objectives:

**At the end of the class discussion of the case:**

1. Students should be able to discuss the major differences between face to face and electronic collaboration in global business endeavors.
2. Students should be able to cite at least one culture that is conducive to supporting global e-collaboration and discuss how culture and task fit into this schema.
3. Students should be able to discuss the 3 levels of involvement in e-collaboration and give an example of each one.

### **3. Courses/Levels and Topics for the Intended Audience:**

- Introductory Global Business
- Cross Cultural Management
- Introductory Strategic Management
- Mid-career executives with limited IT experience in emerging global businesses.
- Mid-career executives with limited international experience

### **4. Classroom discussion (assignment) questions & answers:**

1. What are the similarities and differences between face to face communication and e-communications?
2. How do cultural dimensions affect e-communications? Specifically, after reading about cross cultural dimensions in the suggested readings by Hall and Hofstede, discuss how context, power distance, uncertainty avoidance and task play a role in influencing effective global electronic collaboration.
3. How does the time-space gap of geographically dispersed e-communication affect the interactions and smooth functioning of virtual teams and virtual learning in emerging global corporations?
4. What strategies can be used to overcome the obstacles faced in e-collaboration?

### **5. Teaching suggestions**

Break students up into group of 4-6, each representing a specific project team in a specific country and assign them a brief and simple project that can be explicated communicated by sharing visual materials. As preparation, give the students a lecture and reading assignments

explaining the following cross cultural dimensions: context (Hall, 1969), power-distance (Hofstede, 1980), monochronic versus polychronic time orientation (Hall, 1969) and uncertainty avoidance (Hofstede, 1980). Also, provide the students with sufficient examples to understand the differences between the ends of the spectrum of each of the cross cultural contexts and how the specific task and communication style affects their effectiveness in collaborating electronically on these mini projects.

Ask the students to discuss the following comment made to the author by a Latin executive in a German industrial manufacturing firm: *"When it takes to the act of communicating, despite of the business environment, F2F is still so far the best communication media. This may be an argument against collaborative tools. But here again, the question is not anymore about the quality of communication but to the ability to steer the business in a global scale. What I mean is that the benefit of steering a large team across geographical boundaries is higher than a local high quality communication. I conclude that collaborative technologies are not a matter of preference but a matter of survival in the today's scenario. And the ones who fastest master this discipline benefit a clear competitive advantage."*

After the students discuss the natural preference for face to face communication in conducting business, ask them to discuss what is unique about what [Utopia's] product design team and what can be learned from [Utopia's] best practices as other firms as they embark upon new advanced collaborative technology initiatives?

## **6. References (to provide adequate background for case discussion)**

Four papers [available upon request] from the author of this case including: *Trust*

*and Virtual Teams (2001), Trust and Virtual Organizations (2002), Inequality in IS (2003), E-Engagement in the Cross-Cultural Context of Collaborative Technologies in 21<sup>st</sup> Century Global Business (pending).*

Hall, E. H. (1983). *The Dance of Life: The Other Dimension of Time*. New York: Doubleday.

Hofstede, Geert (1991). *Cultures and Organizations: Software of the Mind*. New York: McGraw Hill.

Richter & Willett (2002). *Lost in Cyberspace*. San Francisco: Jossey Bass.

## **The Buzzards Bay Oil Spill of 2003**

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*Presented at the REGULAR session of the Case Association 2004 Meeting*

Keywords: business ethics, environmentalism, government regulation

### **ABSTRACT**

This evaluative case presents events surrounding a significant oil spill that occurred in 2003 in Buzzards Bay, a shallow body of water near Cape Cod. The purpose is to introduce students to typical policy issues, ethical considerations, and the range of organizations and individuals that have overlapping and conflicting interests in preventing and responding to such an environmental disaster. Students are given the opportunity to evaluate the responsibilities and interests of business, government, community and media organizations and individuals as they respond to this spill. The case facts are based on public sources.

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On Sunday afternoon, April 27, 2003, a tugboat towing Bouchard No. 120 – an unmanned, 28 year old, single hulled barge, owned by Bouchard Transportation Company – entered Buzzards Bay. Shortly after entering the bay, apparently outside the designated shipping lane, the barge struck bottom and ripped a twelve-foot by two-foot gash in its hull. The crew of the tugboat continued to proceed up the bay as thousands of gallons of Number 6 fuel oil spilled into the water from the damaged hull of the barge. (The crew afterwards claimed they had been unaware of the damage to the hull.) Eventually another tugboat captain noticed a sheen on the water and at 4:30 pm informed the crew towing Bouchard No. 120. At 5:30 pm the captain towing the Bouchard 120 reported the sheen to the Coast Guard Marine Safety Office (MSO) in nearby Providence, Rhode Island, as required by law. By that time the barge had traveled approximately 15 miles up the bay from the point where its hull had been breached, and it was in the central portion of the bay. The crew anchored the barge and began transferring fuel oil out of the compromised cargo tank into unbreached tanks. The largest oil spill in Buzzards Bay in almost 35 years had just occurred, the second largest in its history.

The response to the ensuing environmental disaster followed procedures mandated by federal law. It involved dozens of local, state, and national organizations and included governmental agencies, private sector companies, and citizens' groups. As local residents saw their livelihoods affected and their coastal environment ravaged they turned very critical eyes toward both the owner of the oil barge that had leaked the oil and also the US Coast Guard, the agency responsible for monitoring oil barge activities in the bay. As individuals became aware of the complex legal and regulatory arrangements surrounding the transport of oil through the Bay, they raised serious questions regarding the rights and responsibilities of the many parties sharing the Buzzards Bay environment and spoke out strongly in favor of changing current policies and practices.

#### THE BAY

Buzzards Bay is an estuary 28 miles long and on average 8 miles wide, with a mean water depth of 36 feet. It is situated just west of Cape Cod, between the south coast of Massachusetts and the Elizabeth Islands. Its waters are part of a large and popular coastal boating and recreation zone that extends along the southern coast of New England from Block Island to Martha's Vineyard and Nantucket. The abundant shellfish in the bay provide the basis for a commercial shell fishing industry of approximately \$4 million annually, and the rich shellfish beds also support large amounts of recreational shell fishing. Approximately 500 commercial shell fishing permits are issued each year for the bay, and the catch of quahogs, softshell clams, scallops and oysters amounts to 25 % of the commercial shellfish catch in Massachusetts. In addition to providing excellent shell fishing and water recreation opportunities, the Bay's waters are home to a wide variety of wildlife including fish, seals and sea turtles. The bay's many coastal marshes provide

nesting opportunities as well as migratory stations for large numbers of birds, including threatened and endangered species such as the piping plover and the roseate tern. It is therefore not surprising that the Massachusetts legislature has designated Buzzards Bay an “ocean sanctuary,” providing it with a measure of legal protection against pollution and development.

Buzzards Bay, however, is also the shortest route for shipping to proceed up the east coast of the United States. At the head of the Bay is the Cape Cod Canal, which allows vessels to get from the south coast of New England to Boston Bay and points north while avoiding the long and dangerous trip around the tip of Cape Cod. The US Coast Guard has responsibility for regulating and monitoring this shipping activity along with the large amount of recreational boating that occurs in the bay and through the canal. Oil barges constitute one routine element of the shipping that makes its way through Buzzards Bay to the Cape Cod Canal. They carry an estimated four billion gallons of fuel oil through the bay each year, destined for customers throughout coastal New England from Boston north. Massachusetts does not insist on local pilots for barges traversing the bay, and most barges use non-local company employees who may be unfamiliar with local channels or other navigational information for Buzzards Bay. Some of the barges supply the Mirant Canal Power Plant, located at the north end of the canal, which generates electric power for the Cape. This plant was, in fact, the destination of the barge that caused the spill.

In the wake of the huge 1989 Exxon Valdez oil spill into Alaska’s Prince William Sound, the US Congress passed the Oil Pollution Act of 1990 (OPA 90) requiring, among many other provisions, that oil tankers be double hulled. This provision of the OPA 90 is widely credited

with drastically reducing the amount of oil spilled from tankers in US waters beginning in the 1990s. However, because of the expense involved in double hulling a generous phase in time period was incorporated into the legislation. Consequently, depending on the age and other characteristics of a vessel, it may be allowed to operate with a single hull until as late as 2015. The first priority at the national level was to double hull the huge supertankers, such as the Exxon Valdez. The modest oil barges – with a capacity of *only* five million gallons – often have late double hulling deadlines. These are the vessels that routinely traverse Buzzards Bay. Moreover, the federal OPA 90 supersedes any state effort to insist on double-hulled vessels in their coastal waters. Federal jurisdiction in this matter was established definitively when the Supreme Court ruled against a Rhode Island law mandating double hulls in its coastal waters. Thus, though Buzzards Bay is a protected marine environment, an “ocean sanctuary,” single hulled barges are permitted to use the bay, and 82% of oil barges that traverse the Bay are in fact single hulled.

#### THE CLEAN UP

On April 27<sup>th</sup>, when it received the call from the Bouchard crew reporting the spill, the Coast Guard MSO in Providence, RI had in place an oil spill response plan mandated by the OPA. It immediately began activating this plan by contacting appropriate response personnel. By 7:12 pm a Coast Guard boat stationed at Woods Hole had reached the barge, and shortly thereafter a Coast Guard helicopter with a federal hazardous materials team onboard overflew the area and erroneously confirmed that a sheen extended from the barge. (*Sheen* is a technical term that refers to a very thin layer of oil indicative of a minor spill. In fact, a *slick* extended behind the



barge, a much thicker trail of oil indicative of a serious spill. However, in the poor lighting conditions the hazmat team did not recognize this condition.)

Though at this point the general belief was that the spill was a minor one (the Bouchard crew initially estimated 1,000 gallons) the response team continued to assemble quickly in order to assess the situation as thoroughly and promptly as possible so that appropriate remediation could begin. By 8:20 pm the Coast Guard MSO was on scene. By 9 pm the Coast Guard had briefed the National Oceanic and Atmospheric Administration (NOAA), by 10 pm they had briefed the Massachusetts Department of Environmental Protection (DEP). By 11 pm the private company Clean Harbors, the Commonwealth's lead contractor in hazardous materials spills, had been contacted, and divers were on the scene beginning examination of the damage to the barge's hull. By 11:30 pm a tug had arrived with 1500 feet of 16 inch boom and was encircling the barge, containing the oil still spilling from it. At about 12:30 am on April 28 the divers reported the twelve-foot gash in the bottom of the hull, providing the first evidence of the seriousness of the spill. At 2 am the first shoreline booms were deployed to protect 2000 feet of shoreline at nearby Woods Hole.

By early morning the Unified Command structure mandated by the OPA 90 for handling an oil spill was implemented. The purpose of the Unified Command is to ensure that federal agencies, state agencies, and the party that causes a spill (called the responsible party) work together smoothly during the critical early response phase. Prior to the OPA the responsible party – who is financially responsible for the cleanup – was not part of the command structure, creating many difficulties in gaining quick and appropriate action by the spiller. The Unified Command

required three individuals to coordinate their activities and share power, while giving final authority to the Coast Guard. The three individuals who would act as a troika sharing the leadership responsibility were USCG Captain Mary Landry, the Federal On-Scene Coordinator (FOSC); Bob Donovan of the Massachusetts DEP, the State On-Scene Coordinator (SOSC); and Dave Berry from Gallagher Marine, the company hired by Bouchard to conduct the cleanup work, who would act as the Responsible Party Incident Commander (RPIC).

Shortly after 7 am Captain Mary Landry, Bob Donovan, and NOAA scientific support coordinator Steve Lehmann viewed the spill in an overflight of the area. After surveying the extent of the spill Captain Landry requested the assistance of the Coast Guard Atlantic Strike Team. This elite, quick response team is designed to provide high-level immediate assistance in serious oil spill and hazardous materials incidents. The request for their assistance was an acknowledgement of the seriousness of the spill.

The Unified Command also contacted the Massachusetts Division of Marine Fisheries, which has jurisdiction over fishing in Massachusetts coastal waters, and after a brief survey of the situation this agency closed most of Buzzards Bay to shell fishing pending resolution of the immediate emergency. It gave no indication when the shell fishery would be reopened, stating that once the situation stabilized it would have to conduct tests of individual beds to determine when the beds were safe for fishing.

After securing the barge from further spillage and making plans to have it removed to a repair facility the Unified Command settled into the (frantic) routine of skimming oil from the bay,

booming to prevent oil from entering coastal areas where possible, and removing visible oil from shore areas when it did come on shore. Each morning the Command would conduct a fly-over, based upon which decisions would be made regarding specific actions for the day. Eventually, there were ninety-three miles of affected shoreline. At the height of activity there were over 750 workers cleaning the affected beaches on a daily basis. Local harbormasters assisted in the effort by monitoring and identifying water and shore problems within their jurisdiction. On the beaches paid hazmat workers in protective yellow suits collected oiled sand and seaweed into plastic bags, creating mountains of waste material. Individual concerned citizens, as well as established citizens' groups such as the Coalition for Buzzards Bay provided some assistance in actual cleanup, but this was limited by the toxicity of the oil and the need for both special training and special gear in order to come in contact with contaminated material. In terms of providing information, the Buzzards Bay Project National Estuary Program affiliated with the Massachusetts Office of Coastal Zone Management, proactively collected information from agencies and media and posted this material on its website.

It was a difficult time, many birds and other wildlife had been oiled and perished. The oil was messy, smelly, and ugly. But progress was made. On May 8<sup>th</sup> skimming operations could be discontinued because there was no longer any visible oil on the water to remove. By May 15 the first round of removal of visible oil was complete on many affected beaches. This meant that oiled seaweed, sand, and stones less than two inches across had been bagged and removed. As a local fire chief said, "The gross contamination is done." (Moskowitz 2003: A5). In another huge step forward, on May 22<sup>nd</sup> approximately half of the closed shellfish beds were reopened,

and by the beginning of the summer season on Memorial Day most beaches were sufficiently cleaned that they could be opened.

Throughout the summer workers continued to further clean sandy beaches, rocky shorelines and salt marshes to meet immediate response standards for cleanup. By the end of the summer most areas were able to pass a first level inspection: on sandy beaches there was no visible oil, on rocky shorelines there was no sheen and no wipeable oil, and in the salt marshes there was no sheen. At this point, the immediate response phase was considered completed, and on August 29, 2003 the Unified Command Center was closed. Members of the Unified Command expressed satisfaction with the coordinated performance of the many agencies under Captain Landry's leadership. They credited the United Command structure and the response plans mandated by the OPA 90 with minimizing the damage that occurred as a result of the spill by improving response time and decision quality. They handed over what they believed to be a well-managed operation to existing state agencies, who would work with Bouchard, under a federally mandated Contingency Plan that would engage in a comprehensive damage assessment and develop a remedial action plan that would involve additional years of effort

## THE OUTCRY

During the day on April 28<sup>th</sup>, as the Unified Command swung into action, the media also began to cover the spill. Local TV stations provided aerial shots of the barge and the slick on the bay, and announced the immediate closing of the bay to shell fishing. By late in the afternoon the first reports of dead oiled birds were being announced. Though Morton Bouchard, the CEO of Bouchard Transportation Company, appeared on the local news extending his personal apology

for the spill, then estimated as 14,700 gallons, media reports reminded the public that family owned Bouchard Transportation Company, a major barge operator on the east coast, had a history of prior accidents, including a spill in 2002 in New York City's East River in which the Bouchard tug operator was found to be legally drunk. (Urban 2003 4/29)

Over the next several days there was extensive coverage of thick globs of oil coming ashore on local beaches and of dozens of dead oiled birds. (Eventually, approximately 500 bird carcasses were recovered.) An aid station was set up in a local zoo to provide emergency treatment to oiled birds, and this effort received extensive media coverage. Hazardous materials workers in yellow suits were filmed on local beaches as they bagged oiled sand and seaweed. And shell fishermen put out of work by the shell fishing ban were interviewed regarding their plight as a class action lawsuit was filed against Bouchard on their behalf. Five local tourism boards also announced that they were suing Bouchard for lost tourism revenues.

Local and state politicians spoke up vociferously in favor of holding Bouchard accountable for the environmental damage that was occurring, they toured the stricken areas, and they held public meetings to listen to the concerns of constituents. Massachusetts Governor Mitt Romney received prominent coverage when he visited affected beaches and expressed his outrage at the damage, while praising the excellent work of the cleanup crews under the direction of the Unified command, a common view in the early days of the cleanup effort. US senators and representatives from Massachusetts publicly requested that Bouchard agree to a voluntary ban on single hulled oil barges in Buzzards Bay, a request that Bouchard rejected.

When on May 21<sup>st</sup> the Coast Guard released a new estimate of 98,000 gallons spilled by the barge, seven times the initial estimate, public hostility toward Bouchard skyrocketed. Local politicians and residents alike complained that an error of such magnitude seemed improbable. In the stories reporting this changed estimate, the media included a statement by the governor that he would introduce a bill to increase state penalties for oil spills, including stiff fines for anyone who knowingly provided false or inaccurate information. The state Attorney General was reported to be gathering information to determine whether Bouchard was criminally hampering the investigation into the oil spill. US Attorney Michael J. Sullivan also announced that there was an ongoing criminal investigation of Bouchard by his office in conjunction with the state's attorney general, the Coast Guard Investigative Service, the EPA's Criminal Investigations Unit, the US Fish and Wildlife Services Law Enforcement Division, and the state Environmental Police. As various public officials complained about the lack of firm information regarding the spill, Bouchard attorney Austin B. Olney commented that provisions of the OPA of 1990 made it difficult for companies involved in oil spills to provide information. He pointed out that the "criminalization of maritime accidents has had a profound effect on the amount of information to be made available to the public." (Urbon 2003: A1) On June 12<sup>th</sup> yet another estimate was released of the oil spill amount, by a firm hired by Bouchard. This time the estimate was for approximately 38,000 gallons. There are legitimate difficulties in determining the size of an oil spill because of oil and water mixing in the ship hull during the spill, and the Unified Command was unable to get a clear determination of the specific size of the spill. Eventually it reported that the spill was somewhere between 50,000 and 98,000 gallons. While it freely acknowledged that the total environmental impact of a 100,000 gallon spill would be much greater than the impact of a 15,000 gallon spill, it strongly maintained that the confusion

about the size of the spill had not in any way impacted the cleanup effort. The Coast Guard's initial response is always based on a worse case scenario until that assumption is proven false. Thus in the early hours Captain Landry moved as quickly as possible to contain the oil spilling from the barge. Beginning with daylight of April 28<sup>th</sup>, only hours after the spill, cleanup actions were based on information gained from daily fly overs of the affected area and other physical inspections, not surmises based on Bouchard's estimates of the amount spilled.

Amid these shifting figures and in a climate of growing suspicion, local residents and politicians alike expressed frustration at the structure of the Unified Command – in particular the close relationship between the Coast Guard and Bouchard representatives. According to the provisions of the OPA 90, Bouchard was responsible for providing the oil spill estimates to the Coast Guard. These estimates were then provided to the public through joint statements that initially obscured the fact that Bouchard was the sole source. Similarly, Bouchard was solely responsible for getting its tugboat crew tested for drug and alcohol impairment. The initial Unified Command statement simply reported that the crew had tested negative. When it later was revealed that there had been an 18-hour delay in conducting the drug and alcohol tests on the tugboat crew – negating their value in determining the crew's condition at the time of the spill – local officials complained that the offending company should not be in charge of getting such tests for its own crew. Though the Coast Guard and the Massachusetts DEP – the other two members of the Unified Command – repeatedly stated that Bouchard's inclusion in the command structure did not put it in a position to adversely affect the outcome of the cleanup effort or to obstruct the investigation into the spill itself, there was increasing criticism of this arrangement. What is more, as individuals became wary of the Unified Command as an approach to the

cleanup, they voiced increasing concern about the closeness of Coast Guard personnel with the barge operators that they regulated on a daily basis.

## CONCLUSION

Thus as the summer came to an end and the Unified Command was disbanded after completing a complex and demanding initial response to the spill, few residents took any pleasure from the fact that the Command had led a largely successful coordinated effort to clean the beaches and shoreline. People resented the hundreds of birds that had died and the many still unopened shellfish beds. They were suspicious that the close involvement of Bouchard Transportation Company, the responsible party, in collecting initial data regarding the accident had irrevocably clouded the facts of the case making it more difficult to hold Bouchard fully accountable. State officials were examining ways to tighten regulation of navigation within the bay, and making plans to require local piloting in the bay. The state's congressional delegation was exploring the possibility of federal legislation shortening the phase-in period for double hulled barges. The Coast Guard's credibility as the regulator of bay shipping had been called into question, and residents were still deeply suspicious of Bouchard Transportation Company's actions and motives surrounding the oil spill and the ensuing cleanup efforts. All parties to the cleanup seemed in agreement that changes in policies and practices were necessary, but few agreed on specifics.

## DISCUSSION QUESTIONS

1. Why did Bouchard 120 spill 50,000 to 98,000 gallons of oil into Buzzards Bay on April 27, 2003? What are the immediate as well as the deeper causes of this accident?
2. Identify the stakeholders for this oil spill, and their stakes.



3. What is the role of federal, state, and local government agencies in the protection of the environment of Buzzards Bay, the regulation of shipping in the bay, and the clean up of oil spills? What is the role of the Oil Pollution Act of 1990.
4. What were the consequences of this spill? To whom?
5. Who is responsible for these consequences? Legally? Financially? Morally?
6. Is the Buzzards Bay oil spill within the acceptable range of environmental consequence of oil utilization in advanced economies?
  - If you answered yes, how should the environmental impact be paid for, and how should cleanups be managed? Do you have any suggestions for improvement in the provisions of the Oil Pollution Act of 1990 regarding the organization of cleanup activities?
  - If you answered no, what specific action(s) would you recommend to prevent future occurrences such as this spill? What challenges might someone face in trying to implement your recommendation?

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# THE BUZZARDS BAY OIL SPILL OF 2003

## TEACHING NOTE

### ABSTRACT

This evaluative case presents events surrounding a significant oil spill that occurred in 2003 in Buzzards Bay, a shallow body of water near Cape Cod. The purpose is to introduce students to typical policy issues, ethical considerations, and the range of organizations and individuals that have overlapping and conflicting interests in preventing and responding to such an environmental disaster. Students are given the opportunity to evaluate the responsibilities and interests of business, government, community and media organizations and individuals as they respond to this spill, and to shape their own views on the moral responsibilities of the parties involved and the appropriateness of the mandated cooperative cleanup procedures. While the author has met several of the characters in this case, and has seen the environmental damage at first hand, the case facts are based solely on public secondary sources.

The purpose of this case is to expose students in an undergraduate or MBA Business Ethics or Business and its Environment course to

- the ethical considerations involved in determining responsibility for environmental damage and in evaluating remedies in such cases,
- the complex interactions among numerous stakeholders and government regulators when an environmental issue is addressed,
- the technical complexity of environmental issues, and the consequent difficulty in determining the “facts.”

If students have had an exposure to ethical concepts such as utilitarianism, Kantian rights, and justice, these can be integrated into the discussion, but it is not essential that students have such a background. Similarly, if your course focuses on environmental ethics, concepts such as NIMBY can readily be incorporated. However, a meaningful discussion can take place without utilizing these terms.

There are many possible approaches to developing the main points of the case. Following is a description of how I have used the case in an undergraduate class. In an MBA class, more students might have directly relevant business experiences.

Because there are so many actors, I find it useful – prior to discussing the ethical implications of the case – to have the class briefly review the bare facts of the spill and the wide variety of actors involved. To accomplish this without prematurely getting into discussion of the ethical ramifications, I generally begin by having students help me develop two lists on the board – first a timeline of the spill and then a list of the major players. Next I lead the class in a discussion based on answers to the following study questions that appear at the end of the case.

1. *Why did Bouchard 120 spill 50,000 to 98,000 gallons of oil into Buzzards Bay on April 27, 2003? What are the immediate as well as the deeper causes of this accident?*

This question is designed to get students to think carefully about the connections here. A range of student answers can generally be elicited.

Specific answers include items such as:

- The tugboat captain was off course and struck bottom.
- There wasn't a double hull so the oil leaked into the bay.
- The tugboat crew didn't call the Coast Guard quickly enough.

Broader answers include items such as:

- Shipping interests are allowed into this delicate environment because of the danger of going around the Cape, or alternatively because the barge operators have influence. Or barge operators are allowed such a liberal phase in of double hulls either because they have convinced authorities that they should be given liberal treatment because of the economics of the situation, or again because they are powerful interests.
- The economy is very dependent on oil, and so oil barges have to be allowed to deliver oil, or alternatively oil interests are so powerful they have coopted the government that creates regulations that allow them to get away with hazardous activities in order to increase their profits.

My goal is to elicit a range of these thoughts, and then use that to build a discussion of the big picture.

2. *Identify the stakeholders for this oil spill, and their stakes.*

Students readily identify the following types of stakeholders:

- Local residents – their living environment is being degraded,
- Boaters, recreational shell fishers and vacationers – their play environment is being degraded,
- Commercial shellfishermen – their livelihood is threatened,

- Businesses in tourist-related industries – their livelihood is being threatened,
- Bouchard Transportation Company – it is responsible for paying for the cleanup and is exposed to a wide range of potentially large settlements, not to mention criminal charges,
- Citizens’ groups interested in Buzzards Bay environment – concern for the ecological system and the wildlife in the bay,
- the affected wildlife, and the environment itself – its survival (ecological ethics),
- the “people” – a shared national/global resource that is being degraded..

Again, I generally try to get students to generate as broad a list as possible, paying attention to points of potential disagreement. I then try to promote as vigorous a discussion about the various stakes and their relative merit as possible. Some students have a particularly hard time envisioning that wildlife and/or the environment has a “stake.” If time allows it is also worthwhile to discuss which stakeholders are likely to be most energetic, powerful, informed etc.

3. *What is the role of federal, state, and local government agencies in the protection of the environment of Buzzards Bay, the regulation of shipping in the bay, and the cleanup of oil spills? How does the Oil Pollution Act of 1990 fit in?*

In response to this question I hope that students try to articulate the connections among local, state and federal level agencies. Students readily build on the distinctions between the local harbor masters, the Massachusetts DEP, and the Coast Guard in the case. Of course there are many other players at all levels. Their purpose is to elicit a discussion that shows the different stakes being represented by each level. For instance, the

harbormasters in a specific area are very concerned with very local cleanup because they represent the interests of the local town; the commonwealth agencies are more interested in keeping coastal waters clean than in worrying about national-level tradeoffs between double hulling super tankers and double hulling smaller oil barges. A federal entity like the USCG represents the national compromise struck by the OPA 90, sometimes to the disadvantage of the state and local parties. The Supreme Court decision overriding Rhode Island's attempt to ban single hulled ships from its coastal waters is a good example of that tension.

4. *What were the consequences of this spill? To whom?*

The consequences may already have been referred to by this time, when the class discussed stakeholders and stakes. But I usually find it useful to go over what kinds of things happened, even if just quickly. Consequences include:

- Temporary oiling of the beaches for local residents and visitors, with some long-term damage.
- Large expenditures of money for the US, state, and local governments
- Lost income for shell fishermen and tourist-oriented businesses.
- The deaths of hundreds of birds, and the possible further stressing of endangered species

5. *Who is responsible for these consequences? Legally? Financially? Morally?*

My purpose in discussing this question is to get students to think about responsibility at different levels. Most students readily state that Bouchard is legally responsible and

should be held financially accountable. But there is generally an animated discussion about who is morally responsible. I try to get students to suggest several parties:

- The Bouchard crew, because they seemed to make a number of “mistakes.”
- Bouchard Transportation Co. because they insist on using single hulled barges to traverse this delicate environment.
- The federal government because they have given oil barges such a slow phase in for double hulling despite knowing the hazard involved.
- Coast Guard personnel for enforcing regulations in a lax fashion.
- State regulators for failing to create state level regulations in areas where they could, such as local pilot rules.

6. *Is the Buzzards Bay oil spill within the acceptable range of environmental consequence of oil utilization in an advanced economy?*

This is the foundation for the final debate we have in class. I try to get students to take opposing views – one being that you can never have absolute environmental safety and there will always be the possibility of error, the other being that such an environmental outcome is simply unacceptable. Then I push holders of either view to think more concretely about feasible actions that might be taken, given their views.

- *If you answered yes, how should the environmental impact be paid for, and how should cleanups be managed? Do you have any suggestions for improvement in*

*the provisions of the Oil Pollution Act of 1990 regarding the organization of cleanup activities?*

Students who think that occasional oil spills are a cost of doing business may be able to make the leap to suggesting that if residents are benefitting from the electricity generated by the oil-fired power plant, perhaps they should all share in the burden of cleanup costs for spills to a certain extent, i.e. that there is an argument for public moneys to be spent in a cleanup.

The OPA 90 provides a comprehensive policy and administrative framework for dealing quickly and efficiently with an oil spill, but it caused hostility in the public because of a perceived conflict of interest. If students believe that this cooperative framework does result in good outcomes, can they suggest any modifications that might make the process less subject to criticism?

- *If you answered no, what specific action(s) would you recommend to prevent future occurrences such as this spill? What challenges might someone face in trying to implement your recommendation?*

For those who believe that the oil spill in Buzzards Bay is an unacceptable assault on the ecosystem of Buzzards Bay, what specifically would they do to improve the situation? Double hulls, local pilots, greater enforcement of channel restrictions? How would they go about getting such changes implemented?

The purpose of this final discussion is to get students to dig deeper into the nuts and bolts of the regulatory framework in which we operate – and to think actively about how to manipulate elements of it to achieve outcomes more in line with their beliefs.



## **The Truth that Everybody Knows?**

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Keywords: cross-cultural communication

### **ABSTRACT**

This case stimulates discussion of challenges companies face in communicating organizational values across cultures. Sarah, a Human Resources manager in the Luxembourg branch of a major multinational company recently formed in a merger, knows that she must explain to staff visiting from NY headquarters why recent corporate communications regarding the new company's values and diversity vision statements have not been well-received in Luxembourg. The case can be used to explore cross-cultural differences in communication, cultural differences in sensibilities regarding discussions of values and ethics, and the care that must be given to cultural integration in cross-cultural mergers and acquisitions.

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Sarah Evans turned her chair around so that she could directly face her window on the outside world. She had discovered that she could do her best thinking when she sat quietly gazing at the lights of the city. It had been a long emotionally exhausting day, with little opportunity to think about what she wanted to say tomorrow when Brian and Kenya arrived at the Luxembourg office. Sarah knew the meeting with the corporate Human Resources and Communications staff from the New York headquarters would be a challenging one. They would be looking to Sarah and her colleagues for answers to the question they had posed in their e-mail two weeks ago, in which they had requested tomorrow's meeting. "What's going on in Luxembourg?"

Sarah herself was both puzzled and disturbed by what seemed to be going on in Luxembourg. When the merger between G.T. Huntley and Stone had finally been completed a year ago, she and her fellow G.T. Huntley Human Resources Management colleagues had been relieved. The merger, which had united two of the western world's large financial institutions, had brought her Luxembourg branch office into a huge multinational multi-service bank, now with branch

operations in more than 60 countries. The immediate flurry of post-merger integration in operations had proceeded relatively smoothly. Moreover, the inevitable employee anxiety about losing their jobs in the consolidated company seemed to have diminished during the past six months.

Sarah remembered the initial meetings with the HR and Corporate Communications staff from New York shortly before the official merger had been finalized. All involved in the meetings seemed to have a clear understanding of the challenges ahead with integrating two strong corporate cultures. Since those preliminary meetings it was obvious that much time and energy had been devoted to trying to build the new company's culture, blending what was perceived as the best of both companies' cultures. Sarah and her colleagues had been pleased to hear that one of the issues receiving priority attention involved presenting the firm's expectations and initiatives so that employees could collectively strive to achieve the newly-merged firm's objectives.

Shortly after the new company became a legal entity G. T. Huntley Stone's new guiding principles were introduced. A new mission statement had been developed, outlining major strategic initiatives and four corporate values which were to guide the company. Integrity, respect, excellence and innovation were to be the principles by which all employees conducted business. Furthermore, a vision statement regarding employee diversity at G.T. Huntley Stone was included.

An elaborate communications program had been put together by the New York headquarters Corporate Communications and Human Resources offices. The program's stated goals were to reach the more than one hundred thousand employees worldwide, stressing the importance of bringing everyone onto the same page and aligning operating principles. Sarah smiled as the phrase "bringing everyone onto the same page" flashed through her mind. She remembered the puzzled looks on the faces of several of her German, Belgian and French colleagues who did not understand that common American idiomatic expression.

The communications campaign had included a corporate communications day for all employees world-wide with senior executive speeches discussing the future of the new company, either live or via video-conference. Each employee had received a coffee cup and a wallet card with the company's four core values and slogans promoting the importance of employee diversity and employee leadership. Posters with the same information were visible in each branch world-wide and regular communications about company leadership and diversity efforts were posted in offices and elevators. Occasional e-mails were sent to all employees world-wide detailing progress.

The fluttering sensation in Sarah's stomach returned briefly as she recalled fragments of conversations she had overheard in the employee canteen shortly after the corporate communications day.

"The themes and messages in all the corporate communications are written from an American point of view *for* persons with an American point of view."

“Some points of this corporate culture they are pushing are good, but really, is it all too idealistic and difficult to work in the real world?”

“It’s ridiculous that the diversity posters include images of minority American sports heroes! Diversity obviously means something different in the U.S. than it does in Luxembourg.

“The whole thing is *so* American!”

Sarah remembered the comment one of her Human Resources colleagues had made a week or so later: “Well, I guess this campaign is not so well received in Luxembourg.” That was certainly the understatement of the year!

Now almost a year had passed and employee reactions had not substantially improved. After each new e-mail or global announcement Sarah heard the same type of negativity expressed wherever employees gathered.

“The cheerleading messages are often unreal and so unnecessary... it is only blah, blah, blah.”

“I feel like they’re shoving this whole values thing down our throats.”

A quite heated but more reasoned discussion had come up in one of Sarah's MBA classes several weeks ago. Several of her G.T. Huntley Stone colleagues, all mid-level managers like herself, had been telling the class about the whole corporate communications campaign. One colleague had described the values statement and the vision statement regarding employee diversity as condescending and heavy-handed. After two class colleagues who worked at other multinational companies asked some rather probing questions, those from G.T. Huntley Stone finally agreed that most of the dissatisfaction and the employee concerns seemed to stem from the statement of two of the values - integrity and respect – plus a seemingly very USA-specific view of employee diversity. One of her fellow company employees had put the values issues this way: “Values are common sense. Respect and integrity are not traits learned as an adult in the office. Those values stem from how you were raised. Either you are respectful and have integrity or you aren't and you don't.” A class colleague had nodded, adding, “It's like they're trying to teach us truth - but everybody already knows that truth.” After half an hour of discussion among her class colleagues, who actually represented many different nations, the conclusion drawn seemed to be that the American business trend of making corporate values and principles explicit was not as well accepted in Europe.

Yesterday Sarah had asked several of her colleagues at different levels in the company for their perspective on the situation. “Why is it,” one had asked, “that they feel the need to have these points continually reiterated and the words hung on the wall?” A department manager had mentioned that people seemed to be upset because the core values discussions were increasingly linked to organizational processes. “I don't agree with discussions of these values in the hiring process. Nor do I see a reason to have them incorporated into our annual performance appraisal

process.” One of the vice presidents offered his opinion that the current culture building efforts illustrated a different sensibility about the interface between the organization and its employees. And in the elevator ride back to her office a client services representative put it this way: “The principle of building a specific type of corporate culture is good, but it doesn’t work. People don’t fight it but they don’t agree with it. If after the tenth time, you hear about demonstrating the values, you just agree with it.”

In this morning’s Human Resources staff meeting the topic had once again dominated the conversations. After representative employee comments were shared one colleague said, “Yes, I understand what people are saying. During my years of working for Stone and now G.T. Huntley Stone, I have rarely worked with people who did *not* demonstrate the values on a daily basis. Their personalities encompassed these traits and it was taken for granted.” But a recent addition to the HR staff who had worked previously with a team in another unit commented, “Recently one of my team members did *not* demonstrate these values and it was extremely helpful to have a standard, a guideline to refer to and use as a point of reference in the appraisal process. The firm’s expectations of behaviors are clear to its employees - and non-compliance is not a choice. This is the case whether you are sitting in New York or Luxembourg or Singapore.”

The sound of a knock on her door jarred Sarah back to the present. “You’re still worrying about this, aren’t you?” her colleague said. “You know, there’s not necessarily any disagreement about the values or the benefit of employee diversity, just the way they were presented.” “I know,” Sarah said softly, as her colleague closed the door and left.

Indeed, after Sarah had received the “What’s going on in Luxembourg?” e-mail, she had called the New York HR office and had tried to suggest that the company might need different ways to approach the issues in Luxembourg. She too had been dismayed at the results of the recent survey of all employees world-wide. The survey, aimed at seeing how things were going in the new company, indicated that the Luxembourg office had among the lowest employee satisfaction scores world-wide. Sarah was experienced enough with employee surveys to know that numerous factors might contribute to the low scores. Yet she could not help feeling that the scores reflected some concerns which the New York office needed to better understand.

“Wish I knew how the communications campaign has been received elsewhere,” she said out loud, although there was no one present to hear her. Then she remembered a curious point in the survey results breakdown. Indeed, her boss had asked her about the figures. It seemed that the French-speaking audience at G.T. Huntley Stone was typically more cynical regarding the corporate messages than the Anglo-Saxon employees. The headquarters communications did not seem to bother the Irish and the British employees as much. Could she explain why to Brian and Kenya?

Sarah knew that it would not be enough to simply explain what she had learned by talking with people in Luxembourg. Further in the infamous “What’s happening in Luxembourg?” e-mail were clues indicating that the headquarters staff thought the Luxembourg office might need much more of the same type of communication to increase their commitment and boost their morale.

Sarah turned slowly back to her desk and tapped a computer key to restore the screen saver which, ironically, had the G.T. Huntley Stone corporate logo and streaming text reading: “Integrity... Respect... Excellence... Innovation...” Her challenge tonight was to develop some specific suggestions for Brian and Kenya. Tomorrow’s joint exploration of the issues was her opportunity to facilitate shared understanding of issues which would be critically important for G.T. Huntley Stone.



## Case Teaching Note

### The Truth That Everybody Knows?

#### Case Overview

*The Truth That Everybody Knows?* is a case intended to stimulate discussion of the challenges companies face in communicating important organizational issues across cultures to offices in different countries. The story is told through the musings of Sarah, a Human Resources manager in the Luxembourg branch of a major multinational company recently formed as the result of a merger. Sarah knows that she must somehow explain to Human Resources and Corporate Communications staff visiting from the New York headquarters why the recent communications campaign regarding the new company's values and diversity vision statements have not been well-received in Luxembourg.

The case can be used to explore cross-cultural differences in communication as well as cultural differences in sensibilities regarding discussions of values and ethics. *The Truth That Everybody Knows?* also underscores the care that must be given to cultural integration in cross-cultural mergers and acquisitions.

#### Intended Audience and Case Positioning

This case was written for use in a MBA cross-cultural management and communications course. The case is positioned midway through the course after students have learned cross-cultural concepts such as high/low context communication and have discussed cross-cultural differences in approaches to business ethics. *The Truth That Everybody*

*Knows?* could also be used in a graduate mergers and acquisitions course or a business ethics course.

### **Case Learning Objectives**

*The Truth That Everybody Knows?* is intended to enable students to:

- explore dilemmas inherent in cross-cultural corporate communication within companies
- explore cultural differences in reactions to explicit statements of corporate values and codes of ethics
- discuss potential problems in post-merger/acquisition cultural integration efforts
- realize the importance of careful planning of how corporate issues will be communicated across global divisions of a company

### **Time Requirements**

Assuming students have read the case prior to class, a discussion of the major case issues can be accomplished within sixty to ninety minutes. More time may be required if the instructor has small groups work on developing detailed recommendations for a process to plan corporate communications campaigns.

### **Discussion Questions and Suggested Points to Include During Class Discussions**

*What do you think G.T. Huntley Stone was trying to achieve with their communication campaign regarding the new company's core values and diversity vision statement?*

Undoubtedly, G.T. Huntley Stone was trying to deal with the challenges of merging two corporate cultures by presenting clear expectations to guide all the new company's employees, no matter where they were located, in their efforts to achieve firm objectives.

The challenge of merging corporate cultures of two companies from the same national culture is difficult enough and is often cited as a reason for the high failure rate of mergers, acquisitions, and joint ventures. When different national cultures are involved as well, the challenge is considerably more complex.

In essence, the communication efforts were intended to help build a new corporate culture which could unite employees. The core values and the diversity vision statement were but two symbols of the desired corporate culture. In reality, there were numerous other components of the culture campaign, such as a new corporate employee slogan, a mission statement, the employee communications day, and multiple initiatives associated with the diversity efforts.

Advice that multinational companies should create management symbols and mold a strong corporate culture is common in the international business literature. Mead (1998), for example, suggests that managers build positive cultures by using such symbols to build commitment among employees, by promoting company values, and by encouraging organizational members to share these values. Rodrigues (2001) discusses the importance of developing global corporate core values that can be applicable for all divisions no matter where they are located. He suggests that such core values can help to promote balance in practices among geographically dispersed organizational units.

***If the values and vision campaign offered potential benefits, what could have contributed to the negative reception of the campaign in Luxembourg?***

To assume that only one or two factors contributed to the negative reception in Luxembourg is simplistic. Systems concepts would suggest that problems are likely to stem from multiple influences, all or many of which may be inter-related. The case does not give sufficient information to discern what other potential influences could have been but certainly cultural differences may have played a role in the negative reception in Luxembourg.

The communications campaign had been designed in G. T. Huntley's New York headquarters office, no doubt incorporating the currently accepted North American management wisdom regarding the importance of a strong corporate culture, its role in cultural integration, and the necessity of frequent company-wide communication regarding the mission, core values, and vision of the company. What the designers of the whole campaign apparently neglected to take into consideration was potential cultural differences which could affect acceptance and buy-in to the program. The contention that ideas and management models are context specific and thus difficult to transfer elsewhere is well supported in the cross-cultural literature (Hofstede, 1997; Schneider & Barsoux, 2003; Trompenaars, 1993).

A strong corporate culture is often assumed to be glue that holds geographically dispersed units of multinational corporations together (Schneider & Barsoux, 2003), although numerous cross-cultural scholars argue whether organizational values are as powerful an influence on employee behavior as national culture (Schein, 1987; Laurent, 1986; Hofstede 1997). Yet the company's desire to promote a strong culture with very explicit values is understandable and admirable.

Efforts to build culture, however, need to be done in a way that is consistent with the ideals and philosophies of the desired culture. In this case the company had the best of intentions but inadvertently sent a message contrary to their own values – especially respect. Because many people in Luxembourg somehow understood the message differently, the end result was that people did not feel respected. Indeed, while the case describes a negative reaction in Luxembourg, there could have been a wide range of reactions to the values and vision campaign in various company offices around the world.

***How might cross-cultural communication differences help to explain the reception of the core values and diversity vision program in Luxembourg?***

Perhaps one of the best known and most helpful cross-cultural communication concepts is Edward and Mildred Hall's (Hall, 1995) differentiation between high context and low context communication. The Halls suggest that context, or the information that surrounds an event or communicated message, is inextricably intertwined with the meaning of the event or the message but that various cultures pay more or less attention to the context of the communication.

In low context cultures communications are expected to be direct and explicit. The meaning of the message is transmitted mainly through the words that are used. In high context cultures, however, the meaning of a message is highly dependent on the people and the situation involved. More may actually be communicated by what is *not* said. High context cultures value subtlety. Communication which is too direct or explicit is avoided and may be interpreted negatively. The Halls (1995) believe that differences in these orientations are the most frequent cause of cross-

cultural communication difficulties and misunderstanding, although certainly cultures can be compared on a scale ranging from high context to low context communication patterns.

The high/low context communication concept is relevant to the transmission of both written and oral communication in organizations. Dodd (1998) contends that such differences in the ways that members of various cultures process information have implications for how much employees are expected to know about rules and acceptable practices without being told. Some cultures expect organizational members to know what to do while others spell out the expectations explicitly. In high context cultures organizational members are expected to know how to act; thus rules, norms, and expectations remain implicit. The context of a particular situation provides the cues for behavior in these cultures. In low context cultures, however, where information is more explicit, expectations for behavior may be presented via the use of rules, procedures, and even values statements and operating principles.

These communication contexting differences may have affected how the predominantly French employees in Luxembourg perceived the headquarters messages from New York. The French are considered a high-context culture and thus could have perceived the explicitness of the values statements to be insulting – hence the reaction that New York was “shoving this down our throats.” The USA and the UK, however, are considered low-context cultures, in which directness is expected and valued. Thus explicit messages are not only better accepted but are often actually required for understanding. Although many employees in the USA also complain that corporate mission, vision, and values statements are shallow, they are more likely to accept that the explicit statement of such ideas in organizations is legitimate. Differences in the degree

to which communication context affects understanding and evaluation of the message reflect differing cultural assumptions regarding what information is appropriate and relevant.

*Sarah's MBA class discussion alluded to different sensibilities that the Luxembourg employees seemed to have regarding statements of core values and codes of ethics. Can you think of factors other than communication differences that might influence willingness or reluctance to discuss such issues?*

The case author's numerous discussions with colleagues and MBA students in Europe have revealed differing sensibilities, in general, among Europeans and North Americans regarding explicit statements of corporate values and codes of ethics. Donaldson (1996) explains that in many cultures values are usually unspoken. He describes a South Seas island society which uses the word *mokita*, meaning "the truth that everybody knows but nobody speaks (p. 12)." Such a conception of values is consistent with the comments of Sarah's fellow employee, "Values are common sense. Respect and integrity are not traits learned as an adult in the office. Those values stem from how you were raised. Either you are respectful and have integrity or you aren't and you don't."

Such differing sensibilities may indeed stem from communication differences but they may also be influenced by the recent business and societal contexts in which the popularity of such business ethics codes and values statements has arisen. The United States has experienced a seemingly unprecedented number of ethical lapses by businesses. Whether there has, indeed, been an increase in the number of unethical business practices or whether the American press and public are now just more attuned to such problems is unclear. Undoubtedly, however, the

accompanying rise in the use of corporate codes of ethics and values statements is a reaction to public concern about business scandals.

Thus, in the last decade the approach to organizational values and business ethics in the United States is much more explicit than in most countries. Rodrigues labels the uniqueness of the American approach compared to the majority of the developed world the “ethics gap” (2001, p. 66). He speculates that the current explicit approach to business values and ethics may be because there are many more laws governing business in the United States and because the American public both hears and reads more about business misconduct and ethical lapses than do people in many other countries.

***How might G.T. Huntley Stone have approached the corporate values and diversity vision program differently to ensure understanding and favorable reception?***

Most students will suggest that the company should have sought local input on how the program could be successfully communicated in Luxembourg – and other countries as well. The instructor may choose to have students outline a process in which a culture-shaping program and specific messages can be adapted to the local situation. Support for such adaptive communication processes is prevalent in the cross-cultural management and communication literature. Beamer and Varner (2003), for example, advise that successful communication in a global firm requires a careful and well thought-out structure of the communication process.

To follow are some points that instructors may want to include in the discussion:



- Beware the dangers of an ethnocentric approach – or one that could be perceived as such by others.
- It is important to have organization-wide core messages but they must be communicated in a way that is understandable in local contexts. Thus messages need to be transmitted in specific environments, rather than mass marketed.
- Even if English is the official company language, do not assume that everyone will understand the message the same way. Thus delivery of messages needs to be planned to ensure that employees comprehend the message in its intended manner.
- Once desired messages are verbalized in the home country's culture plan how the same messages can be communicated in other company locations.
- For the most critical corporate communications, work with staff in other countries to translate the intended message into native languages, even if the company language is English. The message should not be translated literally; rather the spirit of the message should be verbalized or written.
- Determine the appropriate level of explicitness of the message given the expectations of the receiving culture.
- Solicit the help of managers or communications staff in each country to field test the messages. Have local staff become familiar with the concepts and the spirit of the message and then compare the translation to the intended concepts and spirit.
- Ensure that any visuals are appropriate in each receiving culture (that is, they are not specific to the home country's culture).

Mead (1998) insists that a message can be persuasive only if the communicator selects information that recipients will perceive as relevant to their values and if the message is presented at the appropriate level of explicitness (i.e. the level expected by the receiving culture). He suggests communications planning using the following parameters (p. 145):

- WHO will communicate - Who is the appropriate person to deliver the message?
- TO WHOM - Who are the appropriate people to whom the message should be communicated?
- WHAT - What is the appropriate content of the message?
- HOW - What is the appropriate language, medium and style?
- WHEN - When is the appropriate time for communicating the message?
- WHERE - What is the appropriate location for communicating the message?

***What should the corporate headquarters do now, if anything, to try to rectify the situation?***

Students often suggest some version of an “admit and apologize” strategy – such as:

We have become aware that some company employees have taken our efforts to make our company vision and values explicit in ways we did not intend. We had the best of intentions but inadvertently violated one of our company’s core values – respect. While a great deal of time, effort and thought went into our campaign, we skipped an important step – that of making sure that the spirit and ideals of our message would be received as we intended them in other cultures.

**Additional *optional* question:**

***Discuss the often quoted contention that organizational culture is the glue that holds multinational companies together.***

There is considerable debate in the cross-cultural literature regarding the question of whether an organization's culture and values are as powerful an influence on employee behavior as national culture. This assumption that organizational culture will influence employees from diverse cultures to act in ways desired by the organization is one reason often cited for the desirability of a strong organizational culture in multinational organizations.

A few scholarly viewpoints on the debate follow:

Edgar Schein (1987) suggests that organizational values can be as influential as national values.

Andre Laurent (1986) doubts whether organizational culture operates at as deep a level - implying that organizational culture is unlikely to significantly modify national cultural values.

Geert Hofstede (1997) posits that "an organization is a social system of a different nature than a nation; if only because the organization's members usually had a certain influence in their decision to join it, are only involved in it during working hours, and may one day leave it again" (p. 18). Hofstede's study on values would suggest that our ways of thinking and our approaches will

remain relatively consistent even in the presence of a strong organizational culture.

Carl Rodrigues (2001) believes that “not all corporate cultures transplant well overseas. Companies that try to graft the ‘Stars and Stripes Forever’ in a foreign location will likely encounter resistance. Those that are sensitive to local attitudes and customs are bound to be more successful” (p. 497).

### **Research Methods**

Information for this paper was collected via interviews, class discussions, and from five employees of the company who wrote papers about various issues related to the merger of the two companies involved. The name of the company has been changed as has the name of the case protagonist.

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## **Vecosa (Vegetales Cortados, S.A.)**

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Keywords: Entrepreneurial marketing, Entrepreneurial development strategy, Developing World Entrepreneurship

### **ABSTRACT**

(A) Differences in marketing and development strategy between a new enterprise and an established firm. (B) When to move into a potentially large and profitable retail niche

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The two Vecosa cases have been written for use early in the term of an entrepreneurship course. They focus on two broad marketing strategy decisions for a young Costa Rican woman trying to establish a vegetable processing business in her home country. In Vecosa (A) students are asked to decide which market segment to initially pursue, retail or institutional sales, but it is a rich case on an interesting, easy-to-understand new venture that can be used to illustrate how to:

- (1) evaluate a new venture opportunity,
- (2) analyze a marketing problem,
- (3) research a new venture,
- (4) make an entrepreneurial decision, and
- (5) how an entrepreneurial situation differs from that of a large, established firm.

The question of Vecosa (B) is how to deal with a powerful anticipated competitor. Dole is about to enter a market that Vecosa is also poised to enter. Should the owners try to beat Dole to the punch, or should they wait and follow?

The cases also illustrate general aspects of entrepreneurial life and the particular opportunities and challenges of initiating a new venture in a developing country (and for a young woman). Set in Costa Rica, the cases present a familiar context for developing world students; for students in North America and Europe, the case helps present a picture of life and business in the developing world.

In April 1998, Marcela Solano and her husband Carlos Diones of Costa Rica were ready to commence a pre-cut fresh vegetable business that they had conceived of two years earlier. Although they had already invested in machinery and infrastructure, they would still need to make important decisions about market segments, sales, and strategy.

### **The origins of the business**

In 1994, upon completing her “bachillerado” in Food Technology, Marcela began to work for her family business. After a short time there, she ventured out to work for *Comercializadora Carlson*, a supplier of prepared food for the airline industry. While working at *Carlson* in 1996, Marcela noted the lack of any suppliers of pre-cut fresh vegetables in the region.

Carlos finished his MBA education in 1992 and decided to start-up his own construction company. Having acquired some entrepreneurial experience in the process, Carlos agreed with Marcela that this looked like a good opportunity. Once she decided she would try to establish and lead the new venture, Marcela set about to get the proper training: she traveled to the US to get professional training in food preparation – a M.S. from the University of California-Davis, which had a highly regarded program in this field. There she learned about production and packaging; organic farming; produce processing, selection, and preservation; and the most current technologies to provide safe, hygienic processing and vacuum sealing to maintain freshness. She also took a course in entrepreneurship. Once she completed her degree, Marcela was ready to come home and initiate operations. Investment in the enterprise would come from Carlos’ construction company, which had excess cash at this time. They decided to call the new business, *Vecosa* (Vegetales Cortados, S.A.).

### **The US Pre-Cut Fresh Vegetable Industry**

At the time, the US pre-cut fresh vegetable industry was by far the largest in the world. The first pre-cut vegetable provider had been operating in the US for more than 25 years. The origins

of the industry were with sales to restaurants and hotels, which as lead users could appreciate the benefits of buying pre-cut vegetables (Table 1)

**Table 1. Benefits of buying pre-cut vegetables:**

Portion Control and standardization	Reduction in receipt of raw materials
Minimization of waste	Constant supply, quality, and price
Reduction in storage space	Reduced training costs

**Table 1a. Hidden costs of using (unprocessed) whole vegetables:**

- Preparation at the workstation
- Work injuries
- Employee training and support
- Supervision and control of quality
- Washing and storage of finished products
- Raw material management (ordering, receiving, inspection, storage)
- Waste removal
- Cleaning
- Raw material perishing



Over time, the industry turned towards retail sales through supermarkets. By 1998, seventy percent of total US sales were retail, while 30% were to institutions – principally schools and hospitals, in addition to restaurants and hotels.

Consumption of pre-cut fresh vegetables in the United States had been increasing at an annual rate of 25%, and continued increases were expected. Although the products were now widely accepted, total consumption was still less than a quarter of projected market saturation. In 1997, the American market surpassed \$1.8 billion\* in sales (\$7\* per capita). Most producers entered the market in the past 10 years

*Institutional* sales growth was due to two important trends: First, large companies that bought foods sought increasing savings and efficiency in production. Second, "outsourcing" of non-strategic activities was an important business trend. Both tendencies contributed to the growth of this segment. McDonald's, Taco Bell and other fast food chains were the largest buyers, but there was also a great variety and number of institutional clients.

The principal *retail* buyers were educated women workers. Analysts attributed the growth of retail sales to three factors.

Increasing health awareness. Nutritionists had been recommending greater consumption of vegetables and fruits, due to high nutritious value and low fat content. At the time, the US American Medical Association recommended .250 kg minimum daily consumption of vegetables. Many nutritionists suggest that number should be even higher.

Convenience. Using pre-cut vegetables was easier and it saved time. It had been becoming increasingly common among North American households that both spouses worked and had less time available for household tasks such as food preparation. This is the kind of

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\* All currency figures throughout the case are in U.S. dollars.

product that would appeal to TINCs (two incomes, no children), an increasingly important demographic group.

Retailer incentives. Pre-cut vegetables provided substantially higher profit margins than unprocessed produce.

At the time, the most important retail pre-cut vegetable product was prepared salads. By 1997, consumers could find a wide variety of pre-cut salads, including not only vegetables, but complete packets that included dressing, croutons, and chopped bacon. Sales, growth rates, and market share of the principal companies are shown in Table 2.

**Table 2. US Sales, growth, and market share of prepared salad products**

Business	1997 sales (\$ Millions)*	Change from 1996	Market share
Fresh Express Farms	188	+97%	31.4%
DOLE	127	+150%	21.3%
Ready Pac	67	+111%	11.2%
Supermarket labels	46	+24%	7.7%
Salad Time	35	+285%	5.8%
Others	135	+42%	22.6%
Total	598	+87%	100.0%

\* The average price per salad pound was US\$1.65

Although prepared salads accounted for a third of pre-cut vegetable sales, other products were also successful, especially those considered difficult or unappealing to prepare, such as garlic, onions, broccoli, potatoes and carrots.

### **The Fresh- Cut Vegetable Industry of Costa Rica**

The purchase of pre-cut fresh vegetables was not common in Costa Rica in 1998. Most potential clients, both retail and institutional, were unaware of the product, although there was indication of the emergence of markets similar to those of industrialized countries. (Competitors in both of these emerging market segments are identified in Appendix 1.)

Most restaurants and hotels were still family-run companies that cut vegetables manually, without applying any modern processing. The first fresh-cut vegetable provider, *Empecasa*, had been in the market for fifteen years, serving then-new fast-food chains, and growing as they grew. It was a simple, manual cutting company that did not utilize any of the new technologies that Vecosa would employ.

Retail sales of pre-cut fresh vegetables were minimal. There were few producers, none of whom had attractive or high quality products. The suppliers of the industry were agricultural product wholesalers that bought directly from the producers, but because the products were not an important revenue source, they were not actively managed, and supplies were erratic.

*Automercado*, the country's largest supermarket chain, had their own brand, but neither they nor anyone else actively promoted the product. The line of products available was limited and sales were slow so supermarkets did not provide much shelf space; because there was so little shelf space and promotion, sales remained low. And so, prepared salads, which were so successful in the United States, were still hardly available at all in Costa Rica.

**Market study.** In 1997, Marcela sought to determine the viability of the project. She conducted a market study in which she tried to identify the potential clients, the quantity and type of vegetables they purchased, and from whom they purchased them. She was particularly interested in sales data on the five vegetables with the highest sales volume in the United States: lettuce, cabbage, carrots, onions, and peppers. She separated these potential clients into four groups: fast-food chains, big restaurants, hotels, and supermarkets.

She found, however, the subjects of her study were unwilling to divulge data related to the business. To overcome this reluctance, Marcela pretended to be a government official. Using this ruse, she was able to get data on monthly sales data from at least one branch of the supermarket, hotel or restaurant chain. She used this information to extrapolate annual consumption (Appendix 2), trying to take into account seasonal variation and relative volume of the particular branch.

## **Beginning of Vecosa**

The couple set up shop in an industrial zone ten kilometers from the capital, where they installed their processing equipment, refrigeration chamber, and offices.

The core of the production process consisted of washing, perforation and storage operations. The Diones thought that to excel in the market, the company should use the advanced technologies that Marcella learned in the US –hygienic washing, and vacuum- packing, which would help to maintain freshness and to increase product-life. No existing competitor could offer these features. Therefore, they imported from the United States specialized washing and vacuum- packing machines, as well as specialized machines to cut garlic and potatoes.

## **The Decision**

At this point, the couple had to choose a course to follow. The two broad possibilities they considered were selling to institutions and selling directly to customers through supermarkets. Whatever market segment was to be chosen, the production process would not change substantially. The key operational difference between an institutional and retail strategy would be in packaging, promotions, logistics, sales, and variable costs associated with scale.

Marcela calculated cash outlay for the first year of approximately \$350,000 regardless of market segment – although more money in the institutional segment would go to capital investment (Appendix 3) whereas selling to retail clients would require higher promotional expenses (Appendix 4 details annual fixed costs). To implement either strategy, they planned to hire salesmen to visit the potential clients and convince them of the value of VECOSA products. But despite their optimism over the future of pre-cut vegetables, the Diones had a hard time figuring out how to get started.

**The institutional market.** The Diones observed that the institutional market was already

established and growing. Costa Rica was enjoying a boom in tourism, and the government projected significant continued increases. But Marcela was reluctant to sell to institutions because she felt that, due to the competitive pressures, she could not expect to receive from them a price commensurate with the superior quality of her product. She lamented that price seemed to be the key factor by which suppliers were chosen and that the price-competition in was ruthless.

Doing business with the hotels and restaurants could also be unpleasant in other ways. For example, the hotels would ask for orders with only one-day notice or less than one-day notice. This was partly due to the nature of their business (i.e. to take care of big groups of tourists that arrived unexpectedly), but it was also partly due to the power that the buyers could exert on the suppliers. Because they didn't need to schedule their orders in advance, the hotels didn't do it. This led to instability and uncertainty for suppliers; but that wasn't the hotels' problem.

In spite of these considerations, doing business in the institutional segment provided certain advantages: the distribution points were relatively few, the distances were short (in the capital region), purchase orders were large, and the clients focused on a few products. And despite purchasing irregularities, hotel demand *could* be predicted based on seasonal variation, local celebrations, and special events.

Servicing the institutional segment would require that Vecosa have a constant supply on hand, establish good distribution capabilities, and develop the flexibility to adapt to restrictions, and capability to provide special cuts or meet special demands. For example, one of the fast food chains demanded that supplier's use cooled trucks to transport the product – which would cost an additional \$25,000. Another would require specialized cutting machinery that cost \$15,000.

**The retail market.** Marcela felt generally more attracted to the retail option—in particular the higher potential prices, freedom from ruthless price competition, and the opportunity to produce premium products that would utilize her special capabilities in hygienic preparation, selection, processing, and vacuum packing. Selling in the stores could also allow a more systematic

scheduling of orders. Marcela thought that the retail segment, being in an earlier stage of development than the institutional segment, had more potential. She could open up the market not only in Costa Rica, but also throughout Central America. As in the US, Costa Rican women and other Central American women were increasingly entering the labor market, and had less time to dedicate to household chores.

Despite these positive sentiments, some doubt persisted about the potential of development of the segment. Although the habits of consumption of the United States strongly influenced Costa Rica, some very successful US products, such as the frozen foods, never obtained more than a marginal penetration anywhere in Central America.

Marcela also recognized that retail sales would require additional skills and expenditures. First, the company would have to develop attractive packaging, which would also permit the product to maintain freshness. This was risky, however, because attractive packaging was known to backfire in this market. (Many Costa Ricans consumers believed that packaging increased the sale price to them, and so resisted anything beyond a plastic bag.) Second, would be necessary to maintain sophisticated systems of distribution and information. Most important, Vecosa would have to educate consumers about the benefits of their product, and build a brand awareness to differentiate Vecosa from that of the competition, all of which would probably require substantial investments in promotions and advertising. Marcella estimated she would have to spend at least \$40,000 just to pay for the beginnings of a limited marketing campaign.

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## Appendices

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### Appendix 1. Analysis of the Existing Competitors

#### A: Sales to supermarkets

Producer	Product Line	Strengths	Weaknesses*	Other comments
<b>Cortasa</b>	Vegetables simply	Best known and best distributed (carried in	No clear market	Packing consists of a plate of Styrofoam

	packed Exotic dwarf vegetables	all stores)	positioning Unattractive packaging Short shelf- life	and plastic or mesh cover No uniformity in product or packaging Not vacuum packed
<b>Vege- todo</b>	Exotic dwarf vegetables	Good placement in upper and middle- class supermarkets	Unsophisticat ed packaging Short shelf- life	Packing consists of a plate of styrofoam and plastic or mesh cover
<b>Dole</b>	All types of fruits and vegetables International-style prepared salads and fruits	Known brand and company Deep pockets Management, production, marketing and logistic capabilities Vertically integrated	Limited relationship with local producers Flexibility	Although DOLE not yet had entered the market, its entrance was expected imminently
<b>Revesa</b>	Cut & packed greens and vegetables Ready-to-make “picadillo” (a popular local accompaniment)	Good presence on <i>Automercado</i> supermarket shelves	No brand name Customers do not know the product	Store brand for <i>Automercado</i> Packing consists of a plate of styrofoam and plastic or mesh cover
<b>Corteve</b>	All types of pre-cut vegetables Ready-to-mix with recipes for “olla de carne” (a popular local food)	Broad Product Line Widest distribution	No clear market positioning Unattractive packaging Short shelf- life	Packing consists of a plate of styrofoam and plastic or mesh cover

General Comments: Few consumers know any brand name – rather the products are perceived as generic. Competition in the segment occurs at level of buyer in the supermarket, more than at level of end user. The average price per kilogram of a product found in the market was US\$1.75 with a margin to the distributor of 25% (25% of the price that the final consumer pays), and gross margins to the producer of 50% (50% of the price that the final consumer pays) -or more.

Marcella felt that higher value-added products such as prepared salad mixes could command prices as high or higher than those found in the US, and estimated that average prices for the full complement of products that Vecosa would produce would be about US\$2.50 per kg.

## B. Sales to Institutions

Producer	Product Line	Strengths	Weaknesses
<b>Corteve</b>	All types of fresh vegetables	Wide portfolio of clients Production Plants	Change in management. Similar processing of all vegetables (Not the recommended practice)
<b>Empecasa</b>	In addition to fresh vegetables, they also sell prepared foods	Most established firm in the market Good portfolio of clients (fast-food chains) Low Prices Good relations with suppliers	Unsophisticated production: manual Machinery Poor presentation of product Short product-life
<b>Comagrico</b>	Could not get information	Very low prices	Very low quality Completely manual systems

General Comments: Prices are highly competitive. Chefs usually make the purchases. Knowledgeable chefs like broader product lines, longer product life, and greater variability of cuts.

### Appendix 2. Estimation of Institutional Consumption

#### A. Hotels

Very Large Hotels (5)	3,405,600
Large Hotels (12)	1,034,064
Mid-size Hotels (5)	87,720
<b>Total (Kilograms)</b>	<b>4,527,384</b>

#### B. Restaurants

Total Annual consumption (kg) of onions, peppers, lettuce, carrots, and cabbage

Pizza Buena	1,345,182	Adole	85,413
Aros Dorados	523,755	Fenicia	32,328
<b>KIKOS</b>	<b>517,962</b>	<b>Princesa del Oriente</b>	<b>31,287</b>
Super Pollo	275,880	Nuevo Oriente	10,140
Hamburbuena	144,000	Bonerosa	9,882
<b>Lalos</b>	<b>141,186</b>	<b>Arcos</b>	<b>6,657</b>
Pollos al Carbón	129,693	Ambus	6,135
Cucharaditas	107,484	Others	265,563

**Total annual consumption all restaurants: 3,632,547  
Kilograms**



The average price per kilogram of a product for institutional sales was US\$1.05

**Appendix 3: Summary of initial capital investment (in US\$)**

a) Plant	12,400
b) Large packaging machinery and refrigeration units.	77,400
c) Smaller equipment	2,200
d) Office equipment and supplies	800
e) Licenses	5,200
f) Truck	38,000
g) Working capital	22,000
<b>Total capital investment</b>	<b>158,000</b>

Institutional sales could require an additional investment of **\$40,000** for a refrigerated truck and specialized machinery.

**Appendix 4: Projected Fixed and Variable Costs (in US\$ per year)**

Marcela estimated variable costs of produce, packaging, and delivery to average about \$.55 for institutional sales (typically these costs are about 50% of sales price, but Vecosa’s costs are higher than those of competitors due to advanced processing).

She estimated variable costs of produce, packaging, and delivery in the retail segment to be considerably higher -- \$.62 per kg -- due to higher packaging and delivery costs.

Marcela estimated annual fixed costs as per the table below:

<u>Annual Fixed Costs</u>	<u>Retail</u>	<u>Institutional</u>
Depreciation (25% of Investment)	34,000	44,000
Costs of Vehicles and distribution	15,000	15,000
Administrative salaries and costs	22,000	21,600
Salesmen salaries & associated sales expense	50,000	50,000
Maintenance costs	7,200	7,200
Employee Benefits	26,500	26,500
Other Fixed Costs	12,000	12,000
Retail Promotional Expenses	40,000	0
Financial Costs (15% of Investment Capital)	30,000	30,000
<b>Total Projected Fixed Costs</b>	<b>226,460</b>	<b>211,960</b>
<b>Total Projected Fixed Costs Depreciation</b>	<b>192,460</b>	<b>167,960</b>

Differences in investment in fixed costs depending on market segment are due to the following: Marcela estimated that selling in the retail segment would require additional expected annual expenditures of \$40,000 for marketing, promotions, and packaging – most of which would need to be spent before revenues would come in. On the other side, institutional sales would require additional depreciation of \$40,000 for additional expenditures on a refrigerated truck and specialized machinery.

### Appendix 5a: Costa Rica Demographics

Inhabitants	4,000,000
Percentage of the population with college degrees	7%
Percentage of college graduates who are female	48.5%
Percentage of the population that eat fresh vegetables daily	50%
Annual population growth rate	2,5%
Principal socio-cultural influence	USA
Real income trends	Stable
Consumption of meat	Declining
Average number of people per household	3.2

### Appendix 5b: Central America Demographics

Inhabitants	28,000,000
Percentage of the population with college degrees	3.5%
Percentage of college graduates who are female	43%
Percentage of the population that eat fresh vegetables daily	50%
Annual population growth rate	3,5%
Principal socio-cultural influence	USA
Real income trends	Increasing
Consumption of meat	Stable
Average number of people per household	4.7

### Note on Research Methods

Vecosa came to our attention through a colleague at the Business School at which I served on the faculty in 2000. Carlos had obtained his MBA at the school and stayed in contact with this professor. I interviewed my colleague, and then with the aid of a research assistant, met and interviewed Marcela. All discussions and interviews were conducted in Spanish, and the interview was taped. With Marcela, we toured the Vecosa facility, and took detailed notes. Upon writing a draft of the case, we held an additional discussion with Marcela to clarify remaining questions we had at that point. All the names have been disguised, but only the names have been disguised. Everything else is accurate to the best of my knowledge and abilities.

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## VECOSA (B)

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A year after initiating operations, Vecosa had developed a niche selling pre-cut vegetable for four- and five-star hotels in the capital region of Costa Rica. They also had some sales to fast-food restaurant chains but they had, for the moment at least, abandoned their efforts to penetrate local restaurants and supermarkets.

The couple had decided to focus mainly on the hotels because that was where they were able to make the sale. The salesman they hired failed to make even a single sale, and so Marcella took up the sales effort herself. The first person she was able to convince to give her firm a try was the Canadian chef from an international hotel who was already very familiar with the product, and happy to find such a service locally. As it turned out, several chefs working in the international hotel chains had come from Europe and the United States, were familiar with this type of product, and happy to give Marcella business. Furthermore, at that moment, no competitor was also supplying high quality hotels.

Although price was still important in this segment, by maintaining a good relation with the purchasing managers of the hotels, they could be assured of retaining them as clients and thus protected somewhat from the competition, at least so long as Vecosa maintained competitive prices.

### **Vecosa in 2000**

The company had grown in some of its functions, but in others it remained just as it had been at the beginning. The production area had started with a single person. Now, it had ten employees, although Marcela continued to supervise production. The company began processing 150 kilos of vegetables per day. Presently it processed 800 daily kilos – still well below capacity.

Vecosa produced 22 products. The ten top-sellers were onions, cauliflower, broccoli, chayote, lettuce, mixes for meat dishes, potatoes, hemstitch, green cabbage, and carrots. In addition, if the different cuts were considered (peeled, in squares, grated, etc.) the total number of products reached to 37. This product expansion had made the scheduling production more complex.

The company contracted for product transport, but Marcela continued to manage distribution, and handle sales. For one thing, they couldn't afford a salesman, for another, Marcela liked to get out of the facility and meet the clients.

According to Marcela's estimates, Vecosa had a 15% total market share (institutional and retail). The most important competitor, *Corteve*, had approximately 60% total market share. She considered these numbers very approximate because of the difficulty in obtaining information. She wasn't sure how much information her competitors even kept.

### **A New Question**

Although her business was growing and becoming increasingly secure, Marcela lamented that many of her clients still did not appreciate Vecosa's standards of production, cleanliness, and quality and the value they added to the product. She was bitter about losing one client because a farmer in the public market offered him a price savings of ten colones (less than US \$.04) per kg.

Aside from the increase in the line of products, which complicated production scheduling, Marcela was frustrated by hotel ordering practices asking for deliveries with only one day notice. Finally, the margins in this segment had not been even less than what she estimated—gross margins typically only about 25% of sales price.

Given this situation, Marcela was reconsidering entering the supermarkets with her own brand of pre-cut vegetables. She estimated that gross margins in the retail sector could still reach 50-60% and felt there could be a large potential market. For the moment, Dole not yet entered the

market, but its future entry already had been announced in products such as lettuces, broccoli and cut carrots. Marcela had to make a decision: Should she enter the retail market immediately, prior to the entrance of Dole, or should she wait and see what happens?

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## Teaching Note: VECOSA (A & B)

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### Case Abstract & Intended Use (repeated)

The two Vecosa cases have been written for use early in the term of an entrepreneurship course. They focus on two broad marketing strategy decisions for a young Costa Rican woman trying to establish a vegetable processing business in her home country. In Vecosa (A) students are asked to decide which market segment to initially pursue, retail or institutional sales, but it is a rich case on an interesting, easy-to-understand new venture that can be used to illustrate how to: (1) evaluate a new venture opportunity, (2) research a new venture, (3) analyze a marketing problem, (4) make an entrepreneurial decision; and (5) how an entrepreneurial situation differs from that of a large, established firm.

The question of Vecosa (B) is how to deal with a powerful anticipated competitor. Dole is about to enter a market that Vecosa is also poised to enter. Should the owners try to beat Dole to the punch, or should they wait and follow?

The cases also illustrate general aspects of entrepreneurial life and the particular opportunities and challenges of initiating a new venture in a developing country (and for a young woman). Set in Costa Rica, the cases present a familiar context for developing world students; for students in North America and Europe, the case helps present a picture of life and business in the developing world.

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## Teaching Note: VECOSA (A)

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### Theme (1) Evaluating the New Business Opportunity

#### Is this a good business opportunity?

An early lecture should indicate something on the criteria and evaluation of new venture ideas. Two important concepts to keep in mind about new ventures are *change* and *legitimacy*.

## **Change**

Opportunities are not just there for the taking. People have long ago picked up all the gold that was easy to find and easy to grasp. Therefore, one must be circumspect about what looks like attractive opportunities. Attractive opportunities are likely only to be available under conditions of Social, Political, Technological, or Economic change.

*In this case, what is changing such that we have an indication that this might be an attractive opportunity?*

- (1) New technologies for cutting and packing
- (2) Globalization (more people familiar with these practices and diet)
- (3) Increasing health consciousness (especially relevant for the retail segment)
- (4) More working women (relevant primarily for the retail segment)
- (5) Outsourcing & Specialization (relevant for the institutional segment)
- (6) Increasing tourism (relevant for the institutional segment)

Marcella knows many of these trends first hand; she was working in the area when she observed the lack of product.

## **Legitimacy & Inertia:**

At the same time that change opens the door to opportunities, concerns of legitimacy & inertia limit it. People tend to buy things that they can understand and from people they can trust. Successful entrepreneurs usually have long experience in their industry. Starting up a business is not usually an altogether new direction, but rather part of a career progression. Because it takes such a long time to grow a business into prosperity, it is important that it is a move harmonious with other aspects of the entrepreneur's life. He or she must be willing and able to stick out the long hours and years to bring the enterprise to fruition.

*What is the evidence of "career harmony" in this case?*

They understand entrepreneurship: Family in business, Diego in business

Marcela has already made career commitments: (1) Relatively long association with this field and (2) Work experience and education

These work experiences and credentials give her some legitimacy that entrepreneurs badly need in making first sales.

*Does this **product** have legitimacy?*

Fresh-cut vegetables are popular in the US and Costa Ricans look to the US for trends. Costa Rica has many residents from North America and Europe, and many Costa Rican have lived in North America or Europe.

**Note on the Entrepreneurial Life**

When Marcella spoke to my class in Costa Rica, she told of her long days and early risings (although these tended to get longer and earlier over time – the first time she came she spoke of 14-hour days starting at 3 am. The next time it was 16-hour days starting at 1 am.) She would have to wake up in the middle of the night to go to the vegetable market where she endures propositions and taunts. There were problems with her husband, whom she would hardly see for days at a time.

The plant itself is quite isolated. She is there by herself most of the day with one or two uneducated workers. Our visit seemed to be the big event of the month.

**Theme (2) How to research a new venture**

New ventures are intrinsically difficult to research: It is difficult enough to predict future demand for existing products and services; how do you estimate demand for a product or service that doesn't even exist yet?

Library data is not very useful for these matters, so one must use other research methods. One must gather one's own data and use "analog firms."

*How does Marcella investigate the opportunity?*

Experience - working

Market studies

Additional training

Analog markets



## Costa Rica Market Studies

Vecosa's market studies are rough, but the entrepreneur doesn't normally have much time or resources, and information isn't always forthcoming. Marcella's effort is the kind of "quick and dirty" research an entrepreneur must often undertake.

On the other hand, what can we say about Marcella's "creative" research methods (pretending to be a government official)? Is that wise? (What happens when she goes back to visit later as a potential vendor?) Is it effective? (Are people likely to be honest with a government official?) Does she have any evidence that people will not be forthcoming if she speaks directly, or is it an assumption?

## Analog markets (The US)

**Analogs.** By this time in the course, I have given out an assignment to research a new venture opportunity by conducting interviews using "analog firms." These analog firms are companies that may provide similar services or products, use the same customers or suppliers, or provide the same services or products in different markets.

No analog is perfect. By definition, there are always differences in the new venture in question. But analogs are a primary tool for understanding at least some aspects of a new venture's market and environment. It is important to understand how a particular analog is useful, and what are the particular limitations.

*What analog(s) does Marcella use? What do you think of this choice?*

*Why is the U.S. as a good analog market?*

Good data

Trends that seem to anticipate **Costa Rica** (technology, market features: working women, health concerns, general copying of US trends)

*Why is the U.S. perhaps, not so good an analog market?*

domestic help is Widespread in Central America, rare in the US (Differential Cost of labor)

Fresh vegetables are always available in Central America,

Are Central Americans really interested in “health products.”

### **Theme (3) How to Analyze a Marketing Problem**

The basic question of the case is what market segment to enter. It is expected that students have already taken a basic marketing course, and this analysis should be a review of material learned there and elsewhere in a core curriculum.

#### **Qualitative Analysis**

Students should be able to come up with some basic reasons why they might enter one segment or the other. These basic reasons are listed below and on the Power Point presentation

##### **Institutional Segment: Pros**

Market developed and growing

No need to develop a brand name for consumers

Minimal investment required for machinery and marketing

Anticipated growth in tourism

Trend toward outsourcing

##### **Institutional Segment: Cons**

Market developed and growing

No need to develop a brand name for consumers

Minimal investment required for machinery and marketing

Anticipated growth in tourism

Trend toward outsourcing

##### **Retail Segment: Pros**

Smaller potential market

Strong price competition

Vecosa attributes—cleanliness, quality and product variety—do not add corresponding value

Restaurant chains already have relationships with suppliers

Complex distribution requirements and specialized specifications

Relation of weakness with large hotels and restaurants

### **Retail Segment: Cons**

Additional investments in packing and marketing

Questions about the market development: Is the Costa Rican market comparable to the U.S.?

Limited aisle space in supermarkets

Expected entry of powerful competitor (Dole)

### **Quantitative analysis**

Additionally, students should do a quantitative analysis:

1. estimate the potential market for each segment
2. Calculate the point of equilibrium
3. Do a basic sensitivity analysis

These analyses are provided in the accompanying spreadsheet

### **(4) How to make a business decision?**

1. Determine alternatives
2. List qualitative factors
3. Do quantitative analysis
4. Direct comparison
5. Consider which factors are most important
6. Consider which factors can be mitigated
7. Reflect on your analysis. Test your assumptions. Let the decision sit for awhile -- make a decision you are comfortable with

## **(5) How the Entrepreneur's Situation Differs from that of a Manager in a Large, Established Firm**

The most uniquely important aspect of this case is to illustrate how an entrepreneur's situation differs from that of manager in a large, established firm. A standard business analysis points strongly to entering the retail segment. Probably 90% of students who analyze the case will argue that this is better strategy. A solid marketing analysis would lead a student to recommend pursuit of a retail strategy: The preponderance of qualitative factors favors that choice, and the numbers *strongly* favor the retail strategy: the potential market is much larger, the profit margins are much higher, and the point of equilibrium is much lower. Both qualitative & quantitative analyses strongly suggest that we can expect a higher probable return from retail sales.

**But, the owners did, in fact, enter the institutional market.**

I like to tell them this, and that, moreover, this was a reasonable **decision** that probably worked out for the best.

*why should that be?*

Depending on how you categorize the comments there are three or four related issues distinguish the entrepreneurial situation differs from that of an established firm:

1. The need to reduce risk,
2. The need to lower initial investment,
3. And, most important, to secure clients and establish a business.

These are all highlighted in the accompanying power point slides.

**Risk: In an established firm, maximize expected ROI ... If it's your own money, lower the risks:**

Minimize investment in unrecoverable expenses. [Retail] investment in marketing and packing

design is unrecoverable. [Hotel] investment in equipment is 80% recoverable.

Minimize investment based on assumptions using uncertain information. Estimate of retail market is particularly suppositional. Knowledge of the hotels is much more solid.

**Resources required: If you can get additional investment easily, maximize expected ROI ...  
If not, minimize resources required.**

Minimize investment in the Institutional sector (hotels)

Most important: Concrete customers

**Identifiable clients: In an established market segment, minimize point of equilibrium ... In a new product market, make sure you have someone to sell to.**

There is no such thing as 1% of the Chinese market. There is only 100% of an actual sale.

The problems of Legitimacy and First Sales: Address the problems of vague market and legitimacy with identifiable hotels or restaurants and buyers familiar with the product.

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**Teaching Note: VECOSA (B)**

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**The importance of being there**

Vecosa entered the business through service to four- and five-star hotels, principally because, initially at least, they could only sell their serviced to chefs from Europe and North America who were already familiar with the concept.

So now in 2000 they have an established, growing business. At the same time, all the concerns of this market were manifest: Low margins, arrogant clients, little appreciation of the variability and quality of service they could provide. After two years, Marcella is still scarcely drawing a salary.

But now that they have a business, they are ready to probe the potentially far larger, far more profitable, retail segment. The question is when. A very powerful competitor, Dole, is ready to enter the market.

*Do they wait, or do they hurry up and beat them to the punch?*

**Reasons to enter:**

First mover advantage. Develop a Brand identity

**Reasons not to enter:**

Much the same as before: “Educating the public to buy. Educating the store owners to stock the product.”

Vecosa waited. Dole bought 30 hours of television time introducing their products and “Educating the consumer.” Now that Dole was in the stores, the product had legitimacy. At this time, serendipity (finally) kicked in. Vecosa was *asked* by a large supermarket chain to produce the product under the store’s label.

So, by being there, Vecosa was able to derive many of the benefits of the retail segment without incurring the major costs of marketing and brand development – areas in which they have no expertise to begin with.

**Lessons for small business:**

1. The importance of legitimacy. It takes time and effort to develop relationships, even, perhaps especially, relationships with customers who do nothing more than buy a product in a store.
2. Make up for lack of resources with flexibility. Take advantage of what the large firm provides.
3. Being there. As Woody Allen said, “90% of success is being there.”

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It takes a long time to establish a profitable firm. So do something you are comfortable with. Once you establish a *viable* firm, opportunities for *profits* will arise.

## What Have I Learned?

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*Presented at the REGULAR session of the Case Association 2004 Meeting*

Keywords: marketing, niche, bottling industry

### ABSTRACT

Case Overview Peter Caswell had always viewed the families bottling business as his birthright. He was stunned when his father sold the business while he was still in college. After becoming a successful personal injury lawyer with a bright future, he learns of the Brustlin Bottling Company that was for sale. In the case Peter reviews with Alan Dawes, his long time friend, information he has developed on five successful companies in the boutique soft drink bottling business. He is trying to decide his next steps and strategy to employ in the business.

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Do you remember our old marketing professor? What did we call him? "Tumbleweed" ... that was it because he always looked as if rolled across the prairie somewhere. He was good. One of the things I learned from him was that you should always ask questions. "You never know less than when you started," was his favorite saying. We'll over the last few days, I have asked a lot of questions. And my question is: what have I learned?

It was Tuesday evening in April 2003 and Peter Caswell and his good friend, Alan Dawes, were having a well-earned latte at the local Starbuck's. This was their regular racket ball night and they had played together virtually every Tuesday since they were roommates in college.

Peter continued:

As I mentioned a couple of weeks back, I received a call from a guy who does business brokerage with the information that the Brustlin Bottling Company for sale. I knew Tom Brustlin when I worked for my father. He's a nice guy but he must be in his late seventies now. So, I guess he's retiring and putting the business up for sale. Anyway, I went out and took a look at it. It is old but perfectly functional. And I think he's take \$250,000 for it.

So, I did some research on the bottling industry and also made calls to a number of local bottlers to get a feel for what's going on in the industry. The next step is to try to decide whether what I have learned is of any use. And where I go next. I feel I need to come up with a strategy.

## **Peter Caswell**

Born in November 1968 in Braintree, Massachusetts; Peter was the third and youngest son of the five children of Bob and Sue Caswell. Educated at Braintree High School, he started his college education at Northeastern University. However, at the end of his second year, he transferred to Duke University in North Carolina where he met Alan Dawes. On completion of a B.S. in business he then obtained a J.D. from the same institution. After a spell in Africa with the Peace Corps, he joined the law firm of Haskins, Ryker, and Eisen in downtown Boston making partner in 2000. Still single, he enjoyed a very comfortable existence living in a large house in Wellesley.

His friend Alan picks up the history:

When he was in high school and for the two years he was at Northeastern, Peter worked every holiday and weekends for his father who owned the Carteret Bottling Company. His eldest brother wasn't interested in the business. He went off to the West Coast and became a doctor. Mikey, the second son, was a real hippy and joined a commune somewhere out in Idaho. So, I think Peter always expected that his father would hand over the business to him. I think he saw it as his birthright. However, about a month before we graduated from Duke, his father sold the business. Peter was stunned. He didn't speak to his father for quite a long time. I think the sale of the business was what pushed him to go on and get a law degree.

He has been very successful with HRK. He is now their leading attorney in injury litigation and I wouldn't be surprised if he became the managing partner in the next two or three years. So, I was very surprised when he mentioned his interest in the Brustlin Bottling Company. If he were to take that on, it would mean a real change of direction for him. Maybe he's ready for a change. I don't know.

### **The soft drink bottling industry**

In 2001, the retail sales of soft drinks in the United States totaled over \$61 billion with the average American consuming 53 gallons of soft drinks per person per year. The U.S. market includes nearly 450 different soft drinks. In 2000, 67.8 billion soft drinks were packaged in cans, 25.6 billion in PET (polyethylene terephthalate) bottles, and 0.08 billion in glass bottles.

Competition in the United States is broken down into three levels. The top level consists of manufacturers who are global behemoths. In 2002, they controlled 90.7% of the total market broken down as follows:

Coca-Cola	44.3%
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Pepsi Cola	31.4
Dr. Pepper/Seven-Up (Cadbury)	15.0

The second tier of companies consists of six national firms that account for a further 7.2% of the market as follows:

Cott Corp.	4.2%
National Beverage	2.3
Big Red	0.4
Red Bull	0.1
Monarch Co.	0.1
Carolina Beverage	<0.1

An estimated one thousand plus small local and regional firms share the remaining 2.1% of the market.

This same report indicated that the top ten brands, which accounted for 72.9% of the total market in 2000, were as follows:

Coke Classic (Coca-Cola)	19.3%
Pepsi-Cola (Pepsi Cola)	12.6
Diet Cola (Coca Cola)	9.0
Mountain Dew (Pepsi Cola)	6.4
Sprite (Coca-Cola)	6.2
Dr. Pepper (Cadbury)	5.9
Diet Pepsi (Pepsi Cola)	5.5
Seven-Up (Cadbury)	1.7
Caffeine Free Diet Coke (Coca Cola)	1.7
Diet Dr. Pepper (Cadbury)	1.1

According to *the Beverage Digest*, approximately 31% of all carbonated soft drinks are sold through supermarkets and 14% through vending machines. Fountain sales (i.e., restaurants) account for a further 23% with 6% going through mass merchandisers (such as K-Mart and Target), 5% through convenience stores, and 4% through small grocers. That leaves approximately 17% going through gas stations, drug chains, gas stations/minimarts, airlines and other channels of distribution.

The three industry leaders maintain their position through extensive advertising and promotion. According to *Advertising Age*, PepsiCo (the parent company) spent \$2.21 billion on advertising in the United States in 2001 of which \$164 million were spent on its Pepsi and Diet Pepsi brands, \$136 million on its Gatorade sports drinks (and Prada bars), \$62 million on its Mountain Dew brand, \$41 million on Tropicana orange juice, 18 million on its Sierra Mist brand, and \$13 million on its Aquafina bottled water. By contrast, Coca Cola spent \$903 million of which \$224 million was spent on its Coke and Diet Coke brands and \$76 million on Sprite soft drinks, \$37 million on Minute Maid orange juice, \$26 million on Dasani bottled water, and \$23 million on its Powerade sports beverage. No information is available on Cadbury Schweppes' expenditures on its Dr. Pepper and Seven-Up brands in the United States.

## **Niche Marketing Strategies**

Recognizing from the start that he wouldn't be competing directly with Coca-Cola and PepsiCo, Peter concentrated on talking with those firms that had adopted a niche marketing strategy. Following are brief summaries of these interviews.\* As Peter explains:

I wasn't interested in talking economic with them at this stage. That will come later if I decide to move ahead and look seriously at the acquisition of Brustlin. What I did want to do was find what was happening in the marketplace and discover how some of the small firms are competing.

### **Ascale Beverage Corporation**

#### *History*

- o Ascale Beverage Corporation was incorporated in 1998 and, in late 2000, began the sales and marketing of the first all-natural, lightly flavored, still (non-carbonated) bottled spring waters, called VitaLife. In January 2003, the company introduced a line of all-natural, low calorie spring water beverages, formulated and packaged specifically for children. This line was called VitaDay.

#### *Ascale's Strategy*

- o According to various market reports, Ascale's product line is based on the observation that "children in the United States are heavier than ever, and it is a dangerous trend. Overweight kids are at risk for cardiovascular disease, diabetes, and other diseases. While water is recognized as an aid in weight control, most of us don't drink enough of it. Why? Plain water is boring, difficult to drink. But, high-calorie sodas and exotic beverages with artificial everything are dangerous and unhealthy substitutes."
- o The company's product line consists of seven low-calories fitness waters (with names such as Thunderball Rage and Typhoon Tea) that are bacteria-free and contain no preservatives. The VitaDay products line taste sweet but contain less than 15 calories per serving.
- o Ascale distributes through Safeway, Vons, Dominick's, Pavilions, Randalls, Tom Thumb, Carr's and Genuardis where the products are introduced within the store's all-natural theme stores. They also sell through Shaw's Supermarkets and Wild Harvest all-natural stores than serve more than 2 million customers per week."

- o Among the distributors for Ascale are Health Brands Inc. which is the largest marketer and distributor of all-natural foods - with 16 distribution facilities - servicing over 15,000 retail stores in the U.S. and Canada and United Natural Foods, the largest publicly traded wholesale distributor with over 7,000 customers in 50 states through its 11 distribution centers."

In terms of pricing, the fitness waters are available from the company's web site at a cost of \$31.95 for 24 bottles half liter (16.9 oz) bottles. At this time, the VitaPlay line is not available online.

- o The company would not provide any information as to its advertising and promotional strategies. However, it does promote its product line at trade shows.

### ***The Future***

- o According to Ascale's president and chief executive officer, the company anticipates excellent market response among youths and parents who seek healthier lifestyles for growing children." Although the most recent revenue figures suggest that Ascale has total sales of little more than a million dollars, industry observers suggest that, "looking forward, the company has secured valuable shelf space, which is expected to generate sales revenue in excess of \$7 million for the coming year. The company is perfectly positioned to dominate the 'all-natural' segment of the \$100 billion beverage industry!"

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## **Bertrand Bottling Co.**

### ***History***

- o Founded in 1891, Bertrand Bottling Company began selling birch beer and flavored sodas. At the end of prohibition, the owners saw an opportunity to sell beer and alcoholic beverages and didn't want to deal with birch beer so, in 1934, Marcus Bertrand acquired that business. However, competition became extremely tough in the bottle business and he discontinued bottling and focused on selling birch beer in kegs.
- o The grandson, Alan Bertrand, took over in the 80s and started manufacturing fountain syrups for colas. That business became very difficult when Coca Cola started a division and started to dominate the market. So, he looked around for new opportunities and decided there was a market for gourmet sodas. By August 1993, their first bottle of Bertrand's original birch beer hit the shelves. Marketing in kegs was discontinued around the same time.
- o Today, Bertrand Bottling Company does approximately \$5 million annually.

### *Bertrand Bottling Co's strategy*

- o In terms of the product, Bertrand produces syrup for its 10 flavor of soda (including black cherry - their number one seller - orange, grape, and ginger ale), two birch beers and a diet birch beer at its Waterford, Massachusetts location. All products are caffeine free. The syrup is then shipped to Trenton, New Jersey where the bottles are filled, crowned, and then shipped (either back to Clifton or direct to distributors).
- o According to Alan Bertrand, the company offers a quality product. It uses cane sugar in place of corn syrup. While it is more expensive, he feels it produces a better product. Likewise, they use top quality flavors to produce a superior product.
- o All Bertrand products are sold in the company's own 12 oz. glass bottles with raised lettering and a painted label. While it is much less expensive to use cans or plastic bottles, the company thinks their bottle creates a better image, one that (hopefully) resonates with those who, as children, grew up in a city and remember the bottled drinks. It is designed to be a classy bottle that customers will associate a classy product.
- o 40-45% of the company's sales occur in the metropolitan Boston area. The company distributes the products itself within this area. Outside the area, it is in virtually every major market nationwide. However, outside Boston a network of local distributors handles distribution.
- o It sees its major national competitors as being Stewart's Root Beer, IBC Root beer, and Wyatt-Caso Soda plus a large number of small regional firms.
- o Unlike Coca Cola and Pepsi, Bertrand does not emphasize sales through supermarkets and vending machines. They feel they are not set up to service them. Specifically, they don't have the people or the volume of business to go into a supermarket and fill up the shelves on a daily basis. They do work with a few supermarket but only if they are willing to carry the inventory and handle the shelves.

Most of the company's customers are pizzerias, delis and gourmet shops. They tend to be the high end of the market and want to offer something special. They also work with Starbucks (as an exclusive suppliers of a couple of flavors) and Applebee's where they have an exclusive arrangement in that their flavors are sold in bottles whereas coke, diet coke, etc. is dispensed from a pump.

- o The company admits that, price-wise, their products are more expensive than firms like Coca-Cola and Pepsi. However, while they are at the top of the price scale, they don't feel their prices are prohibitive since there are more expensive products on the market. According to Alan Bertrand, they price their products to appeal to those consumers who want a premium product and are willing to pay a premium for it.

- o Bertrand currently does relatively little advertising and promotion. They used to do some 30-second t.v. spots that ran on cable that were reasonably successful. They also did some radio spots but found this wasn't too effective if people couldn't recognize the product. In recent years, most of the company's promotion at trade shows. Potential buyers come to these shows and sample our various products.  
The company also has a growing relationship with Costco. We set up on Wednesday and Thursday and then have a three-day road show. It gives people a chance to try the product and get to recognize the bottle.
- o The company does not have its own web site. However, it does have a relationship with a number of distributors with we sites and its products can be purchased through these firms.

### ***The Future***

- o The company has recently negotiated an infusion of capital, which will enable it to expand its operations. The president feels they have the potential to become a \$50 million company within five years or so. According to Alan Berman, the company's main weakness is that it doesn't have a cola or a diet cola.

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## **Cressman Bottling USA**

### ***History***

- o Cressman Bottling USA entered the soft drink market in 1937 with a birch beer. Originally sold in barrels, the company soon expanded into bottles and cans. The current owners, who also distribute a number of major beer brands were a major distributor for Cressman and took over operations in the late 80s.

### ***Cressman's strategy***

- o Cressman currently offers seven flavors: sarsaparilla, orange cream, black cherry, cream soda, red birch beer, lemon cream, and root beer. All products are sold in 12oz. bottles and root beer, red birch beer, and orange cream area sold in 1 liter glass bottles.
- o According to the Executive Vice President, Roger Keegan, all its sodas are caffeine free and have very low sodium. Cressman uses multiple blends in its extracts, which is more expensive. While they use corn syrup in their 12oz bottles (which are pasteurized and thus contain no preservative), the 1-liter bottles contain cane sugar and a preservative.

- o The bottles come from Mexico. Cressman manufactures the syrup in Philadelphia and then it then goes to four bottling plants (one in Massachusetts, Two in Ohio and one in North Carolina) and then to its distributors across the country. The one liter dark brown bottle (or barrel) is the company's own design with an expensive label. The goal is to create a quality image.

The company emphasizes old-fashioned traditional flavors. It doesn't offer a cola or a diet cola ... and have no intention of doing so. As Roger Keegen observed, "our goal is to 'keep under the radar' of the Coca Cola and Pepsi. We have a great cola formula but that is not where we want to go."

- o Cressman sells through a network of distributors and also direct to a large retailers such as Target, Wal-Mart, Public and Albertson's. It is represented in most of the major markets across the United States where the product goes to delis, bagel places, and independent convenience stores. The company prides itself on offering a gourmet soda that provides higher margins for retailers. For example, a four pack of 12 oz bottles costs \$2.49.
- o The company sees Stewart's (which is owned by the Snapple Group), Bertrand and Wyatt-Caso Soda as its major competition ... although they feel that Wyatt-Caso is more of a Generation X marketers.
- o The company's advertising and promotion is limited to print advertisement in trade magazines and displays at trade shows. They do some in-store ad but rely heavily on taste testing in stores.

The company is talking to Costco about doing a road show in their locations. According to Roger Keegan, they want people to have the opportunity to try the product and say, "I like that. It tastes like the drinks I remember."

Also, the company gets a lot of feedback from its press releases that always produce a lot of calls.

- o The company has a very active web site and believes this is a great way to get to people. In addition to the listing of its products and the connection to Netgrocer.com, it also have a "What's New" section and a "Cressman Bottling Sighting" section where we post photographs of people with its products. Apparently, customers send the photos in and the company awards prizes such as T-shirts, etc. People also use the site to give the company feedback and comments.

## **The Future**

Roger Keegan stated that they are trying to grow but not so fast as to attract attention. He explained that the industry leaders don't seem to be terribly successful at introducing new products so they are going the acquisition route ... and suspects that many of the smaller bottlers are trying to grow in order to make themselves attractive acquisition targets. Cressman wants to grow through increasing its distribution.

However, there is a problem with this strategy in that Cressman is being cut out at the distributor level. It used to distribute through bottlers of A&W Root Beer. However, they were acquired by Cadbury-Schweppes and that company has a policy of not allowing distributors to sell competitive flavors.

"Some of the independent distributors may be interested but they have forgotten how to sell," Mr. Keegan commented. "They just service the local market. We are hoping for the growth of a new way of distribution. In the mean time, we continue to build up our own. We believe that people want to be different. They want a unique product. We also believe that kids drink what you drink ... and, if they see their parents drinking Cressman Bottling, they will do so."

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### ***Prada Brands Inc.***

#### ***History***

- o According to the company's web site, Prada Brands was founded by Martin Prada in 1996.
- o The genesis of the company (according to a *New Business* magazine article) arose because Mr. Prada (a rock climber and outdoor enthusiast) began to pay more attention to his health. He started shopping at natural-food stores, buying organic fruits and vegetables, and taking vitamins.

According to the article, it all fitted together. "The single most important thing you can do to improve the quality of life is to drink more water and Mr. Prada didn't want it to be just any water. He wanted it to be better water."

"All of the innovation in beverages had come from entrepreneurs," Mr. Prada commented. After all, Snapple was started by three childhood friends who sold natural juices. Nantucket Nectars and Arizona Iced Tea have similar stories."

#### ***Prada Brand's strategy***

- o According to an online newsletter, "Prada Brands is proud of its liquid assets. The company is making waves with its Crassile Water, a line of low-calorie flavored water enhanced with electrolytes and other nutrients."

- o Prada Brands products are available in three varieties under the Crassile name: HealthyTimes (which has extra electrolytes, the minerals your body loses during perspiration) was introduced in 1996. Two years later, the company introduced FruitTime, which has no electrolytes, calories or preservatives but did have some added fruit flavoring. Then, in 2000, the company introduced VitaminTime, which has stronger flavors than the previous products, plus added vitamins and hard-to-miss candy colors.
- o The company started selling its HealthyTimes products through health-food specialists ... first in St. Louis and then nationwide. It followed the same approach with the FruitTimes line. According to a *New Business* article, instead of targeting health nuts, the company went mainstream with the VitaminTime line. As Mr. Prada observed, "Once they had tried it, people said they wanted it everywhere - in universities, health clubs, spas, hotels, delis, grocery stores, gas stations, bodegas, etc."
- o The company puts a lot of emphasis on quality packaging, which Mr. Prada feel is as important as what is in the bottle. Mr. Prada owned a boat that had been designed by a famed architect and, at a reception approached this same gentleman and asked him to help design Crassile's first bottle. Instead of just labeling his drinks with boring names like lemon or honeydew, he decided to give each type a "hip" moniker, such as orange-flavored Total Phase and Raspberry-Lemon Burst. The labels also have catchy copy: 'For best results, mix with individuals showing signs of sluggishness and laziness. Warning: if severe procrastination occurs, buy a whole case.'
- o The company's advertising and promotion are also unique. The company bought billboards in St. Louis and advertisements in national magazines, including *CosmoLife* and *InVogue*. Martin Prada's strategy worked. According to the *New Business* article, you started to see the trendy people on the streets of Manhattan with a bottle of VitaminTime in hand.

The *New Business* points out, however, that "for all its popularity, the stuff might not actually be very good for you. Each 20-ounce bottle (which sells for about \$1.50) contains 125 calories and 32.5 grams of sugar, which is a lot for something that claims to be a health drink. Skeptical nutritionists have questioned whether products like these can even be called 'water,' but the International Bottled Water Association, a trade group, allows companies to add flavors and colors as long as they account for less than 1% of the content."

- o In terms of the marketplace, Crassile is currently second only to Nestlé's Poland Spring. Its other major competitors are Danone Water and Red Bull. Its success has, however, attracted big-name competitors. Gatorade was the first of the large beverage companies to enter the market, introducing its Propel Fitness Water in July 1999. Similarly, Pepsi introduced its flavored Aquafina Essentials in grocery stores this past June. And the newest entrant in the enhanced-water race is Coca-Cola, which launched its Dasani NutriWater in three test markets in November. If that catches on, Coke plans to go nationwide in the spring.



## *The Future*

- o According to *New Business*, Mr. Prada welcomes such competition with good cheer. "The fact that bigger beverage companies are copying us means they think we know better than they do," he says, pausing to chuckle. "Which, of course, we do." The marketing buzz he's been able to generate should help too. Now that he has conquered Manhattan, Mr. Prada's next stop is completing the move into Hollywood. He enjoys offering his drinks at what he calls "lifestyle events." A recent ploy was to provide beverages for the Entertainment Tonight-sponsored Emmy Awards party at the Hayes Hotel in Los Angeles.
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## **Wyatt-Caso Soda Co.**

### *History*

- o The history of the company goes back to 1987 when Andrea Casowski founded Caso Distributors and began distributing fruit juices. In 1995, she created her own products and started marketing bottled waters. Then, in August 2000, she merged with the Wyatt Soda Company to form the Wyatt-Caso Soda Co.

### *Wyatt-Caso Soda's strategy*

- o In 1995, the company began with six flavors (such as Lemon-Line and Strawberry) and later added additional flavors with memorable names such as TangTang Lemon and Crushed Raspberry Blast. Then, in 2000, the company introduced Fast Eddie Energy Drink and, the following year, a line of Wyatt Natural (Fun-Loving Carrot and Wu-Wu's Desire).
- o With the exception of the energy drinks (which are sold in 8.4 oz. aluminum cans) and the natural teas and juices (20-ounce glass bottles), the products are sold in 12 oz. bottles. As the web site states, "while unique bottles and imported water have been successful in the past, Wyatt-Cosa believes that these features increase production costs and reduce the ability of a manufacturer to respond quickly to any changes in the market. So, Wyatt-Cosa provides a stock bottle that is both cost effective and convenient and its labels and support materials have been designed for efficient, low-cost production."
- o According to Thomas Walters, Executive Vice President, "we are a fashion conscious refreshing beverage company. But fashion is beauty and beauty is in the eye of the beholder. We let our customers tell us what is cool. Our niche is the 12 to 24-year old beverage consumer who is into anything from photography to extreme sports and rock n roll. They are tech savvy, skeptical, education, racially diverse, and have spending power."

The unique aspect of the labeling, however, is that the labels are continually changed based on ideas generated and submitted by its consumers. According to *Brand Insights*, Wyatt-Caso offers individuals and consumers a "create-your-own-label" option for special occasions. These include weddings, birthdays, shareholder's meetings, trade shows, or just for the fun of it. As Mr. Walters explains, "Our photo program is vital. When one photo makes a bottle, that person will tell everyone they know about it. The people they tell will tell a few more, and some will take the time to send in their own photo. That is an emotional connection. You inspire someone to get off their ass and become part of something fun. Furthermore, we have patented the right to customize and order branded merchandise over an Internet server. Branded merchandise!! Any branded merchandise!!"

- o Distribution of Wyatt-Caso Soda began with what it calls its "alternative distribution strategy." The company placed its own coolers, bearing its signature logo, in some truly unique venues such as skate, surf and snowboarding shops, tattoo and piercing parlors, as well as individual fashion stores and national retail clothing and music stores. Following the execution of this strategy, Wyatt began an up and down the street attack on the marketplace; this time placing product in convenience and food stores. Finally, the company has now begun to achieve larger chain store listings with companies such as Starbucks, Safeways, Albertson's, and 7-11 stores. While the number of distributors nationwide is confidential, its products can be found in most major markets across the nation.

In the same article, *Brand Insights* identified Wyatt-Caso Soda Co. as partnering with Fresh Bread Inc. to sell co-branded drinks at its specialty fresh bread and sandwich cafes. The custom labels feature black-and-white photos of bakery and related products and the text on the back pays tribute to the bakers who "go to great measures every night kneading, scoring and baking."

- o Wyatt-Caso Soda doesn't do any traditional marketing. It displays its products at fancy food shows, convenience store shows, and surf and skate expos." The company also sponsors "extreme" athletes, surfboarders, and skateboarders. These athletes can be seen promoting Wyatt-Caso and sporting the Wyatt-Caso logo at extreme sporting events across the country. It also has a number of large orange RV's covered in the company logo, which travel throughout cities in North America handing out soda and talking to the people in the street.
- o As far as pricing is concerned, Wyatt-Caso Soda appears to be somewhere between Coca Cola and Pepsi at one end to the scale and the bottlers who use expensive ingredients such as cane sugar and unique glass bottles. "We like to be priced at 99 cents per bottle," Thomas Walters observed. "A pragmatic pleasure."

## **The Future**

According to Mr. Walters, "the future is bright and tasty."

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## **INSTRUCTOR'S MANUAL**

### **WHAT HAVE I LEARNED?**

#### **Case Overview**

Peter Caswell had always viewed the families bottling business as his birthright. He was stunned when his father sold the business while he was still in college. After becoming a successful personal injury lawyer with a bright future, he learns of the Brustlin Bottling Company that was for sale. In the case Peter reviews with Alan Dawes, his long time friend, information he has developed on five successful companies in the boutique soft drink bottling business. He is trying to decide his next steps and strategy to employ in the business.

#### **Intended Audience**

This case was written for use in a basic marketing course. More specifically it would be positioned at the point in the course during which niche marketing is discussed.

#### **Research Method**

Information was gathered by field interviews. All names of companies and individuals have been disguised.

#### **Case Learning Objectives**

This case is intended to enable the student to:

- o Examine a market with well-defined niches
- o Analyze different approaches to establishing a niche based on specific elements of the marketing mix
- o Evaluate these companies' strategies against optimal niche characteristics
- o Review the prospects of the firms in an industry dominated by giants.

#### **Discussion Questions & Teaching Approach**

Since this case would normally be discussed very early in a marketing course, it is suggested that the class begin with a very general question that allows all students to participate. Each discussion prompt or question will become progressively harder and begin to separate the students by capability.

**1. What are some of the environmental factors that create the opportunity for niche marketing?**

Many factors have led to the fragmentation of this industry that provides opportunities for niche marketing. Dalgic and Leeuw listed the following:

- o Single parent households, families with double incomes and no children, yuppies;
- o Working women, overweight people, and tall people;
- o Increasing minority markets;
- o Technological advances;
- o The evolution of consumer countervailing power;
- o Changing demographic and lifestyles;
- o The demands on personal time;
- o Overcrowding of too many products, services and stores;
- o The weakening of the magic in network television advertising;
- o The decline in brand loyalty;
- o Advertising clutter, overkill and waste; and
- o Feeding the discount promotion monster.<sup>1</sup>

**2. What are some of the ways of defining niche markets that may be useful here?**

After encouraging allowing the students to discuss this issue, the instructor may wish to present three different perspectives. Dalgic and Leeuw defined a niche market as a:

*Small market consisting of individual customers or a small group of customers with similar characteristics or needs.<sup>1</sup>*

By contrast, Chalasani and Shani defined it as:

*Carving out a small part of the market whose needs are not fulfilled. By specialization along market, customer, product or marketing mix lines, a company can match the unique needs.<sup>2</sup>*

And Massey viewed it as:

*An organization's position or role within its market or field – the space occupied by an organization within its environment.<sup>3</sup>*

**3. What are the strategies being employed by the companies?**

## **Product**

Product differentiation is the strategy that comes closest to the traditional view of niche marketing. Bertrand Bottling and Cressman Bottling have focused on marketing flavors that appeal to the older generation who developed a liking for soft drinks prior to the growth of the industry giants. Ascale Beverage and Prada Brands have developed products aimed at the health conscious that are looking for a product that tastes better than plain water and contains relatively few calories and no preservatives.

## **Ingredients**

The ingredients used by each firm were consistent with their market niche. Bertrand Bottling and Cressman Bottling utilize more expensive materials, which is consistent with the high quality image that they seek. Ascale Beverage, Prada Brands and Wyatt-Caso Soda were less concerned with ingredients since they are clearly aiming at a less expensive and more price conscious market niche.

## **Packaging**

Bertrand Bottling, Cressman Bottling and Prada Brands have distinctive packages. Bertrand and Cressman felt that using a distinct bottle or label adds to the image of the product. Prada Brands did so because of their belief that packaging is as important as contents. Wyatt-Caso Soda has adopted a unique approach in that labels can be customized with whatever picture the customer desires.

## **Distribution**

Due to the control of the main distribution channels by the majors, slotting fees etc., the niche firms have all resorted to alternate channels. Bertrand Bottling Co. focuses on pizzerias, delis and gourmet shops that want to offer something special. Cressman Bottling follows a similar strategy. Wyatt-Caso has adopted its alternative distribution strategy. It places its own coolers in truly unique places such as skate shops, surf and snow boarding shops, tattoo and piercing parlors, etc. It follows its customers.

## **Pricing**

Pricing strategy is consistent with the niche strategy employed by each of the competitors. Bertrand and Cressman have adopted a premium price strategy, which is consistent with the perception of quality, which they hope to achieve. The other competitors price their product above the major competitors (i.e., Coca Cola and PepsiCo) but below that of Bertrand and Cressman.

## **Advertising and Promotion**

Bertrand Bottling, Ascal Beverage and Cressman Bottling, all use tradeshow. None use radio, TV or magazine advertisement. Parada did use billboards in the New York area and also

used national magazines. Wyatt-Caso uses extreme athletes that tour the country promoting their products.

**4. Are these firms targeting markets that meet Kotler's criteria for appropriate niches?**

At this point in the class, the instructor may wish to hand out a sheet listing Kotler's five (5) criteria for appropriate niches, namely:

- o The customers in the niche have a distinctive set of needs.*
- o Customer will pay a premium to a firm that best satisfies their needs.*
- o The niche is not likely to attract other competitors.*
- o The niche gains certain economies of scale through specialization.*
- o The niche has size, profit and growth potential.<sup>4</sup>*

And then ask the students whether or not the firms described in this case are, in fact, targeting markets that meet these criteria.

**The customers in the niche have a distinct set of needs**

Ascale and Prada Brands clearly focused on the health conscious and the 'all natural' segment of the beverage market. Bertrand and Cressman both targeted the nostalgia crowd that remembered the old-fashioned products. Wyatt-Caso targeted the Generation Y creating products that appeal to them and speak their language.

Customers will pay a premium to a firm that best satisfies their needs

Bertrand and Cressman have found a segment of the market that will pay a high price for nostalgia. Ascale, Prada Brands and Wyatt-Caso have placed their products in locations where the customer is interested in the product itself and thus is far less price sensitive.

**The niche is not likely to attract other competitors**

The niches in this market are rather small and, in general, are unlikely to be large enough to attract either of the majors. However, Prada Brands has obviously developed a market of interest to Coca Cola and PepsiCo. Other niche player might represent a threat. However, with the regional nature of such competition and the multiplicity of channels of distribution, the threat seems small.

**The niche gains certain economies of scale through specialization**

In none of the five companies is there any evidence of economies of scale through specialization. Prada Brands, however, used billboards and national magazine advertising.

Wyatt-Caso adopted a unique approach. They sponsor extreme athletes who tour the country promoting Wyatt-Caso. They focus directly on the customer rather than the channels.

### **The niche has size, profit and growth potential**

While they are mini-niches they certainly have the size required to be very profitable without being even noticed by the majors.

#### **5. Should Peter Caswell pursue this opportunity further?**

Some students will probably focus on the fact that Peter Caswell currently has a very successful career as a lawyer and would be making a serious mistake to give up his professionalism and life style to overcome his perceived rejection by his father more than ten years earlier. They will argue that the soft drink industry is dominated by a small number of major firms and he is never going to have the resources to compete with them. "Forget it" may well be their conclusion.

Other students may have a different perspective. They will probably conclude that there is opportunity in the niche soft drink bottling business. As long as Peter Caswell doesn't go head-to-head with the big guys, he could probably carve out a niche for himself. They may also suggest that people should follow their instincts and that, since Peter has always wanted to be in this industry, he should take a serious look at the purchase of the Brustlin Bottling Company ... especially in terms of the total investment and the likely economics. They will argue that he has very little to lose.

#### **6. What possible niche strategies might Peter employ if he decides to go ahead with the purchase of Brustlin?**

Students should be encouraged to brainstorm the possible strategies (in terms of product, ingredients, packaging, distribution, pricing and promotion) that Peter could employ.

While there is no single strategy in the materials presented by the five companies, students should be encouraged to put together a consistent approach to the market.

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# **Workforce Reactions to Massive Cultural Shifts: The Case of a Changed Consumer Products Company**

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Keywords: change management, organizational culture, human resources, organization development

## **ABSTRACT**

This case depicts an organization that undergoes a cultural shift. The shift is necessitated by changes in regulatory, consumer and operational demands. As a result, the workforce faces aggressive, demanding operating objectives. Human resource initiatives are launched to drive the culture change. Initiatives included a “change management” program incorporating individual job-related, psychological and interpersonal assessments. Assessment data are provided. Readers can diagnose the causes of human resource problems and also improve or comment upon the change strategy implemented by the consumer products company. This case is designed for graduate level management courses, advanced undergraduate courses and industrial/organizational psychology courses.

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## Introduction

Traditionally a stable business, the “American Goods Corporation” (fictitious name) suddenly experienced turbulence triggered by unexpected ferocity from “friendly” competitors, legal developments implicating the use and sale of product and in time, difficulty in measuring consumer preferences. The following case provides details of the business environment as it contrasted with the historical predictability associated with being a global leader in a stable business environment.

The American Goods Company reacted to the business challenges forcefully. For every action however, there is an equal (and possibly opposite) reaction. Both the drivers of change and the workforce’s response to managerial tactics implemented to alter workforce behavior are examined in the case. The reader is given an inside look at workforce reactions in terms of perceptions of job responsibilities and the impact of change on physical and emotional well-

being. The case is unique in that the data are “from the inside” of a genuine cultural change intervention and reflect individual assessment over a period of two years during which time severe, unashamed alterations were implemented.

### The Business Environment

The American Goods Corp. was one of the world’s most successful consumer products organizations. Its operating income from the domestic market of one product category, relevant to this case, was estimated at \$8 billion. This revenue was managed like an annuity. The confidence that such revenue could be generated year in and year out was legitimized by the fact that market share had little variance and that concerns were small regarding extant circumstances that threatened this share of market.

The product category reflected premium brands with generous margins as well as low-end brands with less generous margins. There was little consumer overlap or “switching” of product between brands. The brands were strong, visible and enjoyed equity domestically (as well as internationally). Success for the product category and the workforce committed to the sales and distribution of product lied in flawless adherence to a model of execution that tolerated very little deviance in what and how products were promoted, priced and placed in retail establishments.

The model of “rule compliance” worked for many years. The workforce excelled in following the promotion plans of headquarters. The chain of command was well understood and workers planned a long-term career by “staying out of trouble” which meant *not* disagreeing with management. The workforce was an obedient and reliable one.

Steady growth (in market share and stock price) was enjoyed by shareholders and employees (whom also benefited from stock appreciation directly through deferred profit sharing programs). As long as everyone continued to do what they had done before results were assured.

Competitively, there was little consumer “switching” – brand loyalty was strong. Indeed, arguably in this product category pricing wars were traditionally not a way to do business. Competitors in this market appeared to appreciate each others relative industry standing and given the predictability of earnings, the marketplace did not experience very much creative energy in trying to beat the competition. Consequently, sales professionals and management focused on operational excellence and compliance with plans generated by corporate headquarters. Execution at local levels was carved from the ivory tower – what to do, when to do it and how was pre-determined. And ... this worked.

### The Tide Shifts

Unexpectedly, competitive activity developed in anticipation of legal and regulatory issues arising. The American Goods Company began to experience instability – this being a place never visited before. The competitive activity activated consumers, confused sales management and sent an alert to senior sales management.

On the competitive front, for the first time the industry entered a price war. Fierce pricing strategies and incentives for switching to competitive brands entered the marketplace. In addition, unexpected new entrants appeared in the market with new brands. These brands were “generics” being specifically targeted at the price-conscious consumer. The tactic worked. Premium brand market share began to erode...an unprecedented event. All competitors

launched generics in response. Consumers in large volume, switched to low cost brands – the fight for consumers began and the win was merely a switch to low margin product.

Adding fuel to the fire, legal and regulatory issues erupted. Issues touched pricing, federal and state excise taxes on product and even consumerism advocates began to take swipes at the “value” of the product category. Consumers began to question the industry and brand equity is hit hard. This flurry of legal, consumer and competitive activity demanded that focused attention be placed on the strategic sell of the product category. The formula for success was no longer doing what had always been done. In fact, as market share continued to erode, the “old formula” was simply bad business.

In sum, a bureaucratic, hierarchical, conventional organization faced a shift in business demands. The shift was triggered by a multi-faceted threat coming from legal and regulatory developments, competitive pricing and changing consumer values. The business environment as once known was no longer. The stability and predictability of consumers and competitors was gone. The “chain of command” approach to business planning and execution, once the trademark of efficiency and effectiveness was called into question by senior management. In short, the American Goods Company needed to redefine who it was and how it would achieve business growth. The solution was transformation.

### The Transformation: The People Make The Place

#### Leadership Takes on a New Look

The President of the American Goods Company sponsored a “call to arms” – all senior executives were to be held accountable for the implementation of a massive, national cultural change initiative. The purpose of this cultural shift was to support strategic business objectives

newly derived from a detailed, focused analysis of the existing and developing business environment.

Being profitable by being compliant toward management direction for many years breeds a certain way to think and work. This working culture is expressed in how managers hire, promote and develop the workforce. It is important to realize that the methods implemented during times of stability were effective – they were good and appropriate at that time- given business demands.

Specifically, individuals interested in and comfortable with being in a “chain of command” environment were preferred. The entry-level sales job(s) required little in terms of decision-making, critical thinking, quantitative analysis or even interpersonal acumen. Rather, the ability to follow directions, demonstrate diligence and “not rock the boat” were admirable characteristics. Those characteristics would be assets in a stable, predictable sales environment. Management found, hired, promoted and nurtured individuals of such character. Again, this worked.

The first step taken to “reinvent” the American Goods Company was at leadership levels. A result of a strategic business analysis performed by a top-tier management strategy consulting firm indicated that the American Goods Company would not grow if it did not “execute like a consumer products powerhouse”. This meant aggressive growth was possible but only if it could relinquish its “do as I say” mentality and actually develop a sales organization that could think and do on its own. Basically, capability at local levels required an upgrade so that the American Goods Company could plan and respond at local, relevant territories. No longer could corporate “know all” – too much competitive, local regulatory and consumer activity was taking place in home towns across the nation.

The quickest route to remaining profitable, given the developing business environment, was to learn how to make profit from smaller margins. This translated into higher volume.

Rather than “re-school” leadership – leadership was instead “re-placed”. A search for talent enabled the American Goods Company to raid successful consumer product firms. This resulted in new, experienced leadership. It was also a method that was not previously used by the American Goods Company – going outside “for new blood”.

The placement of senior executives of outside companies caught the eye of the sales organization. Without hesitation, all began to worry. Change was afoot.

#### Hiring Becomes Competency-Driven

The American Goods Company terminated existing hiring practices and froze all hiring until better, more strategic practices could be implemented. During the hiring freeze a systematic analysis of job requirements was launched and on a national sales level, “competencies” both technical (knowledge and skills) and non-technical (skills, abilities, interests, personal characteristics) were distilled.

The result was a “model of requirements” for leadership, management and entry level sales positions. Across the board the competency themes were critical thinking, managerial judgment, quantitative analytical skills, interpersonal savvy, presentation skills, conflict management and financial management. While varying in definition these themes directed how people were recruited, how they were hired and how they assimilated into the organization.

For example, one tactic during the selection process was the creation of a test battery that tapped into many of the requisite competencies. All entry and mid-level recruits were assessed using this home-grown battery of tests – this was implemented as a national standard. Prior to

such rigor applicants were interviewed locally by a first-line hiring manager. The structure of the interview was left up to each individual hiring manager. In short, the interviews were rather unstructured and were not based on a standardized set of competencies.

The distinctive and rigorous nature of the new “high-potential” selection system was a stark departure from traditional modes of identifying and hiring sales professionals. These hiring tools were not only a means to upgrade competence but perhaps more importantly served as symbol of change.

### Performance Management Programs

As a means to clarify performance expectations in the “new organization” the competencies derived for sales professionals, sales management and leadership were translated into a behaviorally based performance review program. This program was standardized requiring quarterly reviews, top-down objective planning and forced distribution ratings at year end. Sales executives referred to this as a “reality-based” evaluation process.

The intent of the new performance management program was to increase sales management accountability for setting the goals of the sales professional (their direct reports). The reality-based appraisal process had two distinct components to it. First, it required feedback from customers directly and second, it required evaluative judgments from the supervisor only, which was a distinct departure from a multi-source approach in the past.

The inclusion of customer input and the elimination of peer input sent a message that the organization was to become strictly customer-driven. The importance of peer input was diminished because it was judged that this information added little value and in many instances, on a national scale, led to unnecessary and even unproductive dialogue and conflict with the



supervising manager. For example, often peer evaluations were positive but the supervisor's evaluation was negative. Senior management believed that the "mutual positive" peer ratings did not reflect reality but rather secured a cultural status quo. Managers attempting to develop people through more aggressive goals and steadfast business metrics were therefore faced with the burden of overcoming data from peers when providing performance feedback. Again this problem was eliminated by basing the performance evaluation on the immediate supervisor's and the customer's judgment.

#### Design & Implementation of a National Learning Center

The analysis on competencies across the organization resulted in the conclusion that upgrades were necessary if the American Goods Company was going to compete successfully in the harsh, dynamic business environment. While better hiring was made a priority and better, more realistic, job performance management programs were implemented – this was not enough.

As a means to accelerate development of high potential newcomers (identified through the new selection system) and motivate sales management, a National Learning Center was established. The Learning Center was a three-tier approach to development – first, entry level sales professional development programs; second, management development programs; and third, leadership development programs.

The Learning Center was established in Dallas, TX making the logistics for travel simple (easy in and easy out) and also a means to communicate the business need to enhance localized decision-making. Prior to this center all major communications and developmental activities were designed and run out of New York World Headquarters. The setting in Dallas provided a statement that "learning can go on and is expected to exist in the field".

An invitation to attend the Learning Center was earned. Participants required nomination by their supervisor. The sales organization was beginning to be “split” between those that are “in” and those that are “out”; the “in-group” being those selected to attend the Learning Center and the “out-group” being those that did not. The sales organization now had an “A” team and a “B” team. This differentiation among the masses was telling and prescient. In addition, the Learning Center was designed and led by Sales Executives – not professional development staff (i.e., human resources or training professionals).

Human resources served as a catalyst in the design of the Learning Center but stayed “behind the curtain” operationally and strategically. Sales Managers were the focus of the Learning Center. Sales Managers were nominated by Sales Executives to become “faculty” at the Center. This credential brought attention to a distinguished track record of both generating sales revenue and managing sales territories. An invitation to be “faculty” was a mark of distinction and became in itself a valuable possession among management. Like the sales force itself (3,000 nationally) the sales management group (350 nationally) was to be separated into those qualified to be faculty and those that are not. Performance at the National Learning Center was evaluated and documented and fed back to management upon return to the job.

#### Personnel Decision-Making Policy

Essentially, performance management became a strategic mechanism to identify deficiencies and improve competencies. It was communicated as a Sales initiative rather than being an “educational” program – to enhance its perceived credibility. In addition, high impact people led the initiative. Senior Executives hand-picked initial faculty and all attendees earned

their invitations the hard way – a combination of generating results locally and demonstrating sound judgment about managing their customers in path-breaking ways.

#### The Performance Management Programs Set the Bar High in the Organization

Achievement was redefined. There was now an “A” team and a “B” team – again a stark departure from a tradition of finding security by not standing out in the crowd or by engaging in mutually protective political behaviors to sustain mediocrity. The old model of working was no longer in sight.

To further the use of performance management practices to drive requisite new behaviors, the annual review process required all managers to rank order their sales professionals. Evidence of performance was behaviorally-based, managers received training from human resources on the use of the new evaluation instrument and along with the competencies mentioned earlier “improvement” too was a key aspect of the evaluation process (e.g., attending the National Learning Center).

Once ranked, relevant teams of Sales Managers gathered to discuss their people and create another ranking on a larger territory basis. Again, human resources played a key role in facilitating these discussions and ensuring consistency of standards at a national level. The result of this process was the identification of the “top ten percent” on a regional level (e.g., five regional territories). This top ten percent received a significant cash bonus awards – at the level never provided before for the sales professionals. The “bottom ten percent” were also identifiable and received a written disciplinary warning, a “get well” agenda and a timeline for turning their performance around. The inability to meet supervisory expectations within the timeline (six months) resulted in termination.

### For Every Action an Equal and Opposite Reaction

The transformation from a slow, bureaucratic, somewhat “lazy” culture into a dynamic, assertive, self-sufficient culture did not occur overnight. Over a span of nearly three years the interventions described above were administered. During this time “growth” took place. The growth was apparent in terms of market share and also breaking into new product categories that never before existed – in itself evidence that the organization became “open” to new ideas. While business grew (after the first year) the workforce shrank. The organization reduced the size of its sales organization by nearly ten percent.

While these results were being manufactured people worked. As they worked they responded to these changes. The response to a business transformation was measured on an individual basis over a two-year period of time.

### The Metrics and Sample

The American Goods Company rolled out a change management seminar to a nationwide sales organization comprised of Executives, Managers and Sales professionals. As a component of this seminar, 190 workers were assessed (first line, management and executives; 121 male; 66 female) using the Occupational Stress Inventory (Osipow & Spokane, 1987; published by Psychological Assessment Resources, Inc. The validity evidence for this instrument is well documented by a series of research studies (Osipow & Davis, 1988; Osipow, Doty, & Spokane, 1985; Osipow & Spokane, 1981; Osipow & Spokane, 1983; Osipow & Spokane, 1984).

The OSI was administered privately by a consultant to the American Goods Company, Sam Johnson who was a licensed industrial psychologist. Sam had been hired to accelerate the cultural change intervention by designing a workshop that would address both organizational and individual development in the context of changes occurring at American Goods. The workshop incorporated individual assessment, counseling and action planning along with the group work. The workshop sessions were 1.5 days, off-site and included most of the evening of the first day. Sam targeted the assessment at three major factors to identify the “impact” of the American Goods Company’s transformation. The three factors were:

- Impact on the job itself (Occupational Roles)
- Impact on personal well-being (Personal Strain)
- Impact on adaptive competence (Personal Resources)

Sam discussed the results of the OSI with each participant. The purpose of the feedback was to create a development action plan for each individual that bridged both their personal and professional needs vis-à-vis adapting to the business transformation. In addition, the OSI results provide a “snapshot” of national workforce reaction to changes in management practices. The American Goods Company was interested in the overall effects of the American Goods Company’s cultural change on its sales professionals.

The OSI was the chosen measurement instrument because the three questionnaires tap into the three constructs that the consultant wanted to measure. Each of the three OSI questionnaires comprises several subscales.

Occupational Roles Questionnaire (ORQ). This questionnaire consists of six subscales, all of which assess the stress that an individual faced related to his or her job. Stress was an extremely important element of this assessment to ensure that employees were not “burned out” as a result of the massive organizational change.

- Role Overload (RO): measures the extent to which job demands exceed resources (personal and workplace), and the extent to which an individual is able to accomplish expected work loads.
- Role Insufficiency (RI): measures the extent to which the individual’s training, education, skills, and experience are appropriate to job requirements.
- Role Ambiguity (RA): measures the extent to which the priorities, expectations, and evaluation criteria are clear to the individual.
- Role Boundary (RB): Measures the extent to which the individual is experiencing conflicting role demands and loyalties in the work setting.
- Responsibility (R): measures the extent to which the individual has, or feels, a great deal of responsibility for the performance and welfare of others on the job.
- Physical Environment (PE): measures the extent to which the individual is exposed to high levels of environmental toxins or extreme physical conditions.

Personal Strain Questionnaire (PSQ). This questionnaire consists of four scales. Here, the emphasis is on the individual’s perceived stress, which is not necessarily directly related to his or her job.

- Vocational Strain (VS): measures the extent to which the individual is having problems in work quality or output. Attitudes toward work are also measured.

- Psychological Strain (PSY): measures the extent of psychological and/or emotional problems being experienced by the individual.
- Interpersonal Strain (IS): measures the extent of disruption in interpersonal relationships.
- Physical Strain (PHS): measures complaints about physical illness or poor self-care habits.

Personal Resources Questionnaire (PRQ). Four subscales make up this questionnaire. Unlike the previous two questionnaires, a high score for personal resources is viewed as positive, as it may help an individual to cope with the occupational and personal stress they experience.

- Recreation (RE): measures the extent to which the individual makes use of and derives pleasure and relaxation from regular recreational activities.
- Self-care (SC): measures the extent to which the individual regularly engages in personal activities which reduce or alleviate chronic stress.
- Social Support (SS): measures the extent to which the individual feels support and help from those around him/her.
- Rational/Cognitive Coping (RC): measures the extent to which the individual possesses and uses cognitive skills in the face of work-related stresses.

Participants in the sample completed all of the subscales, which resulted in a raw score for each subscale. The raw score was then transformed into a T-score (a linear transformation that has a raw score of 50 and a standard deviation of 10) and a percentile using appendices provided in the OSI manual. Both of these measures were used to compare the sample results to normative data from a sample of 909 adults with 130 occupations in technical, professional, managerial and service professions.

Interpretive Information

The OSI manual provides guidelines for interpreting T-scores for the various scales. They serve to alert the person interpreting the scores as to the level of concern that should arise due to an individual’s score. For purposes of the macro-perspective used here, the data presented are the average T-Score for the entire sample, broken down by gender. These guidelines for interpreting the scores are summarized in Table 1.

Table 1. Guidelines for Interpreting OSI T-Scores\*

	Normal Range	Slightly Problematic	Potentially Seriously Problematic
Occupational Roles	T-scores of 40-59 are considered normal, and those below 40 suggest almost no occupational stress.	T-scores of 60-69 suggest mild levels of maladaptive stress (results not statistically significant).	T-scores above 70 suggest a strong probability of maladaptive stress.
Psychological Strain	T-scores of 40-59 are considered normal, and those below 40 suggest almost no psychological strain.	T-scores of 60-69 suggest mild levels of maladaptive stress (results not statistically significant).	T-scores above 70 suggest a strong probability of maladaptive stress.
Personal Resources	T-scores of 40-59 are considered normal, with higher scores suggesting stronger coping resources	T-scores of 30-39 suggest a mild lack of coping skills.	T-scores at or below 30 suggest a significant lack of coping resources.

Source: OSI Manual, Research Version, pages 5 and 6.

In addition to T-scores, percentiles were created by comparing the mean raw score for males and females to normative data. The percentiles represent how the raw scores for this sample compare to the likelihood of such raw scores in the normative data from various



occupations and industries. These percentiles were a benchmark for interpreting the practical significance of the findings.

The Data

Table 2 depicts the T-scores and percentiles for the sample. This information was used by Sam to prepare a dialogue with each participant addressing the potential interplay between job characteristics, personal well-being and individual coping responses. The importance of these factors being related to responsibilities for accelerating the change intervention.

Table 2. OSI Results for American Goods Company Sample based on Mean Raw Scores\*

	Occupational Stress Questionnaire			
	OSI T-Score Results		OSI Percentile Results	
	Males	Females	Males	Females
Role Overload	53	59	83	89
Role Insufficiency	52	47	47	38
Role Ambiguity	54	53	73	72
Role Boundary	53	49	52	48
Responsibility	47	51	43	44
Physical Environment	52	49	60	55

	Personal Strain Questionnaire			
	OSI T-Score Results		OSI Percentile Results	
	Males	Females	Males	Females
Vocational Strain	53	50	59	50
Psychological Strain	52	52	60	62
Interpersonal Strain	49	48	51	59
Physical Strain	54	53	76	65

	Personal Resources Questionnaire			
	OSI T-Score Results		OSI Percentile Results	
	Males	Females	Males	Females
Recreation	50	46	47	40
Self-Care	45	46	30	46

Social Support	52	52	42	54
Rational/Cognitive Coping	48	46	22	33

\*Questionnaire names and American Goods Companying scale names are from the Occupational Stress Inventory, by S.H. Osipow and A.R. Spokane.

Sam received an email from senior management at the end of the change management seminar asking for his conclusions about the impact of the cultural change on the workforce. In addition, Sam was asked for his counsel regarding aspects of the cultural change intervention that were well-designed and perhaps also advise on where improvements could be made. He prepared to respond...

## **TEACHING NOTE:**

### **WORKFORCE REACTIONS TO MASSIVE CULTURAL SHIFTS: THE CASE OF A CHANGED CONSUMER PRODUCTS COMPANY**

#### **ABSTRACT**

This case depicts an organization that undergoes a significant cultural shift made necessary by a changing business environment. The cultural shift aligns workforce behavior with aggressive, demanding operating objectives. Initiatives driving the cultural change are explained. During the course of the cultural change, a workshop was implemented targeted for executives, managers and employees. This workshop incorporated individual assessment on issues related to the job and work itself, personal strain and the ability to manage oneself during times of transition. The results of these assessments are reported in the case. Readers are left with the task of identifying the implications of the cultural change at the individual, team and organizational level. Students are also challenged to improve or comment upon the change interventions used by this consumer products company.

This case is designed for graduate level management courses, advanced undergraduate courses, and industrial/organizational psychology courses that study stress and occupational health and wellness, change management and organization development.

## **TEACHING OBJECTIVES**

“Workforce Reactions to Massive Cultural Shifts” is a case designed around an actual business situation. The name of the American Goods Company is not revealed, as it would be highly recognizable and the name of the consultant is changed. The data were collected by the first author, who was acting as a consultant to the company during its cultural transformation. The main objective of the case is to enable students to look inside a changing business that is undergoing major changes in culture, largely due to human resources interventions that align with the new business model. By placing themselves in the shoes of the consultant who conducted the study, students can come to conclusions regarding the impact of the change on the workforce. The detailed background information on the American Goods Company and the use of primary data are two assets of this case.

## **CASE POSITIONING / USES**

This case could be used in several areas:

- Graduate level management courses, or advanced upper-level undergraduate courses. The key to the relevance of this case for a course will depend on how familiar students are with the relationship between business strategy and organizational culture and the concept of change management. In a management course, appropriate sections during which to use this case would be a chapter on change management or organizational culture.
- Graduate level human resource management courses or advanced undergraduate courses. The case would be relevant during a discussion of organizational culture or as a summary

case at the end of a semester that has covered strategy, as well as the various functional areas of human resource management.

- Industrial/Organizational Psychology courses. The case fits well as an application for the study of organizational stress.

## **PREPARATION FOR CLASSROOM DISCUSSION**

The necessity for an assignment prior to discussing the case will depend on the level of the class. For graduate classes, having the students read the case critically prior to class should be sufficient. For advanced undergraduate courses, instructors may wish to have the students prepare as follows:

- Familiarize students with assessment and the use of norms for interpretation of scores
- Introduce students to fundamentals of psychometrics
- Review the results of the OSI and identify findings most relevant to subject matter being studied (e.g., job characteristics can be targeted)
- Ask the students what they would tell management (if anything) about the results of the OSI assessment
- Ask students to critique the American Goods Corp. strategy for changing the culture

## **CLASSROOM DISCUSSION**

The discussion can begin with the students' interpretations of the OSI results. The results suggest that the overall workforce is not suffering maladaptive stress (although there were individuals who had T-scores in the 80s on the ORQ and in the 90s on the PSQ). However, when one examines the percentiles, it becomes clear that the sample is clearly on the high end of the

normal level of stress. For example, percentiles for role overload were the 83<sup>rd</sup> and 89<sup>th</sup> for males and females respectively. Instructors can ask the class to interpret this finding using their own words. Responses should indicate that this sample's scores were higher than 83-89 percent of the scores from other organizations (those used to create the normative data). In addition, the instructor can ask the students about the other scales for which the sample's percentile was high. (For the ORQ, Rational Ambiguity and Physical Environment were high. For the PRQ, Psychological Strain and Physical Strain were high.) The discussion of the Personal Resources Questionnaire should take a different tone, as these scales assess an individual's ability to cope. They could be considered as a way to offset the high levels of occupational and personal stress that the workforce experienced. The instructor can ask the students their interpretation of the T-scores and percentile responses for the sample. As with the OSQ and PSQ, none of the T-scores indicate that the overall workforce lacks coping skills (although there were individuals with T-scores as low as 13 for Social Support and 17 for Rational Cognitive). However, some of the percentile scores are quite low. Rational Cognitive Coping percentiles were the 22<sup>nd</sup> and 33<sup>rd</sup> for men and women respectively, and self care percentiles were the 30<sup>th</sup> and 46<sup>th</sup>. The instructor can ask the class how this affects their interpretation of the OSQ and PSQ scores. They may consider the high stress levels to be more problematic now that they see for that the sample has lower levels of coping resources than most of the professionals that make up the normative data (all of the percentiles are under the 50<sup>th</sup>, with the exception of social support for females).

#### Implications for the American Goods Corporation

As stated in the case, for every action there is an equal and opposite reaction. Although technically speaking, the reactions of the workforce may not exactly equal or opposite, it appears

that the cultural changes are related to high stress levels. However, as is the case with many organizational interventions, this American Goods Company did not complete a baseline measure before undergoing the change. Therefore, the consultant must be careful not to imply that stress has increased as a result of the change. Indeed, it is conceivable that the workforce could have been experiencing even higher levels of stress prior to the change and the recorded levels here are actually lower than they were prior to the change. Herein lies the importance of the normative data. Sam can report to senior management how the American Goods Company's sales professionals scored in relation to other in technical, professional, managerial and service employees.

The message for senior management is fairly straightforward: the sales professionals have high stress levels and moderately low levels of coping resources. This could be a recipe for disaster if the American Goods Company is planning on retaining these individuals as the leaders of this "leaner and meaner" organization. The instructor can ask the students what Sam might suggest to senior management as a result of the findings. Possible answers include:

- Reduce the organizational stress levels. This is not likely to be well received by senior management, as the American Goods Company had just undertaken a major effort to make the cultural changes and had a business imperative for doing so. In addition, this advice might have been practical before the change was undertaken, since the cultural changes could have been implemented more slowly, so as to give individuals time to adapt; however, at this point, all of the changes have already been implemented and senior management is unlikely to want to revoke the changes, since they are experiencing business success, as measured by profitable volume.

- Implement additional coping resources. This is likely to be a more welcomed suggestion by senior management. Individuals could participate in stress management seminars and/or the American Goods Company could implement additional stress reducing programs (e.g., onsite yoga classes or meditation sessions during lunch or after hours). The American Goods Company may also publicize its employee assistance plan (or find ways to involve it in the change intervention itself), as employees may not be aware of this American Goods Company-provided resource for coping with stress.
- Do nothing. Although this may seem like the least compassionate option, it may actually be the best solution for both the employees and the American Goods Company. If the new American Goods Company culture is going to be stressful, trying to help individuals who are not able to work in this environment may create additional employee stress and have a negative impact on business performance. Individuals with high stress levels and low coping resources may leave of their own volition, or if their performance is inadequate, they may be asked to leave. The main problem with this approach is that we do not have data on whether high stress levels are correlated with low performance levels. If high stress is correlated with high performance, this solution would be ineffective because the American Goods Company could end up losing its best performers.

## **EPILOGUE**

The Change Management Seminar swept across the national sales organization becoming a “credential” that one was leading the cultural change effort. The consultant pre-arranged with the American Goods Company an understanding of the possible outcomes of the consultation.



These outcomes included better performance and overall well-being for those that “adapt” to the new culture and take a leadership position more quickly than it might otherwise occur and also the possibility that the “clarity” achieved as a result of the seminar could prompt voluntary departure.

As a result of the seminar approximately 10% of the participants opted out of the organization. The data was incorporated into a job restructuring plan soon to be in development and led to innovative job designs that encouraged autonomy and challenge for a workforce now more wanting of such characteristics.

The American Goods Corporation remained an industry leader in this product category and has since diversified into other packaged goods on a global level.

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*Presented at the REGULAR session of the Case Association 2004 Meeting*

Keywords: organization change, growing a nonprofit organization

### **ABSTRACT**

The YMCA of Greater Boston's executives decided to expand into East Boston, an economically diverse and challenged neighborhood adjacent to Logan International Airport. In early 1999, the executives selected Wendy Zinn to serve as director of the new program. By 2002, Zinn had harnessed the community's overwhelming need for services such as childcare and after-school programs into a thriving YMCA branch. Success brought a new set of problems: space and a need for greater financial resources. Zinn and the Y executives must decide how to solve these problems.

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### **How the case is used:**

The authors teach this Y case in a MBA program that has an Organization Behavior course that focuses on how leaders grow and change organizations. (More detailed information is given in the Instructor's Manual).

## **YMCA of East Boston**

On a rainy afternoon in July 2002, Wendy Zinn, the Executive Director of the YMCA of East Boston, picked up the main phone line and listened to the parent on the other end. It was the fifth call she had received that day from a parent asking for childcare. Zinn tried to concentrate as she couldn't help but hear the collective noises of 65 toddler and preschoolers who played in the rooms adjacent to her office. She explained to the parent that there were 250 families on the waiting list for toddler and preschool care and there wouldn't be a guarantee of placement before kindergarten. Zinn took the parent's name down and as she hung up the phone she realized that a decision needed to be made quickly on finding a location to expand the YMCA of East Boston's services. Zinn had been reviewing documentation on the Boston & Albany Railroad Engine House location and was preparing her thoughts for a final meeting with the development team, which included the CEO of the YMCA of Greater Boston.

The YMCA had responded to a Request for Proposal on the redevelopment and re-use of the Engine House, which would serve as the main East Boston YMCA facility. The proposed site could offer expanded childcare services as well as traditional YMCA programs such as physical fitness, sports and adult classes. Zinn led the opening of the YMCA of East Boston in 1999 and had established childcare programs at five sites spread around the East Boston neighborhood. Zinn's main Program Center offered daycare for toddlers and preschoolers while the other locations, which operated out of public schools, offered after-school programs. For each of the East Boston sites, lack of space was a serious problem.

The conversion of the Engine House building to a YMCA facility was expected to cost \$5 million. CEO John Ferrell and COO Sandy Walker had identified East Boston as a growing community in need of programs and services but had been contemplating whether or not this investment would be profitable. Although the existing programs had filled a huge childcare gap, it was unclear as to whether an expanded facility would produce similar results. Of particular concern was the likelihood that nearly all potential members would require financial assistance from the YMCA.

Zinn was enthusiastic about the location of the Engine House. It was situated in the center of town on a park and was easily accessible by public transportation. However, Zinn was concerned that prospective members may not join the new YMCA because initially, it would not have a swimming pool and full-court basketball gymnasium. The RFP was only for the building and did not include any additional land beyond the property so it was unclear at this point whether expansion was possible longer term. Also, there were restrictions on renovating the building as it was deemed a historic landmark.

If the YMCA chose to take the property but forgo building a pool and gymnasium, a tremendous cost savings would be realized in the short run. However, looking longer term, would residents of East Boston and nearby communities be willing to join the YMCA without these two key amenities? There were several other agencies vying for the Engine House and although Zinn believed that the YMCA had first priority, there was a risk of losing the space if the decision was

delayed. Zinn wondered if the YMCA did not seize this location, what other might there be? And secondly, when might another opportunity occur?

### **History of the YMCA**

In 1844, Sir George Williams founded the Young Men's Christian's Association (YMCA) in England with a mission to improve the quality of life for young men in the city of London. In 1851, the first YMCA branch opened in America, located in downtown Boston. During World War I, YMCAs ran military canteens, took on war relief for both refugees and prisoners of war, and worked to assist African American soldiers returning to the segregated South. After the war, YMCAs spread rapidly across the U.S., serving men and boys of all ages. Some of the YMCA's began to target specific groups such as factory workers, recent immigrants and African Americans. After World War II, women and girls were offered full memberships and participation. YMCAs played a major role in the history of the U.S. with the creation of basketball, volleyball, and racquetball and by pioneering camping, physical fitness and swimming lessons.

The national office, called the YMCA of the USA, was headquartered in Chicago. In 2000, there were over 2400 YMCAs across the country. YMCAs were run independently and were part of "corporate YMCAs" which operated branches, units and camps. Each corporate YMCA was a charitable, not-for-profit entity, qualifying under Section 501c3 of the US Tax Code. The YMCA's national constitution required affiliates to pay annual dues based on budget size, to refrain from discrimination, and to support the YMCA mission. All other decisions were local choices, including programs offered, staffing and style of operations.

The mission of the YMCA of the USA was:

*To put Christian principles into practice through programs that build healthy spirit, mind and body for all.*

Each corporate YMCA used this mission as a basis for its own statement but added language that was specific to their respective locations, member types and program offerings. For example, the YMCA of Greater Boston's mission was:

*To build health of spirit, mind and body based on the highest ideals of the Judeo-Christian heritage, and to improve the quality of life for children, individuals, families, and communities of cities and towns of Greater Boston.*

### **YMCA of Greater Boston**

The YMCA of Greater Boston was one of the largest corporate YMCAs in the country with 16 branches and 58 program centers throughout the city of Boston and its surrounding areas servicing over 100,000 men, women and children. A branch typically included programs and services including a weight room, cardiovascular equipment, a gymnasium for basketball and other aerobic activities, a swimming pool, childcare programs and summer camp. Program centers were extensions of branches, which served specific community needs such as full-day childcare, youth and teen centers and English as a Second Language (ESL) and General Education Development (GED) classes.

The metropolitan offices of the YMCA of Greater Boston were located on Huntington Avenue and housed the executive team and its largest Branch known as Central. The Central Branch operated a large fitness facility, a variety of programs for families and children and transitional housing to homeless families and single adults.

By the late 1990's, the majority of programs offered by the YMCA of Greater Boston served youths. As more women entered the workplace, the YMCA enlarged its childcare and after-school programs. It became the largest provider of childcare in the state of Massachusetts serving approximately 3000 children daily. After-school programs included swimming lessons, sports, literacy and arts and humanities. Some of the branches offered adult programs such as job training, ESL and computer classes. These programs were established to provide skills to

those who were underpaid or temporarily out-of-work and allowed individuals to improve their standing in the workforce.

## **Organization Structure**

The CEO of the YMCA of Greater Boston was John Ferrell who had held the post since 1993. Sandy Berlin Walker, COO, reported to Ferrell. Walker was responsible for the oversight and supervision of the 16 branches. Each branch had an Executive Director who ran their respective YMCA and reported to District Vice President or in some cases, reported directly to Walker. The District Vice President position was created as a means to promote Executive Directors and broaden their responsibilities. Executive Directors managed their branch with some degree of autonomy, but were obligated to follow the policies and procedures set forth by the Greater Boston corporate office (See Exhibit 1 for the Greater Boston Corporate YMCA organization chart).

The Corporate office had a General Board made up of prominent members of the Greater Boston community. The role of this 57 person general board was to provide policy and oversight to the YMCA. Each branch had its own Board of Managers which served in an advisory role. The chairperson of each branch board had voting privileges on the General Board.

## **Branch Support**

The metropolitan offices of the YMCA of Greater Boston offered support services to each of the branches and program centers. The major departments within the corporate office provided consultation and oversight to the branches. These departments included finance, accounting, financial development, childcare resources, marketing, public relations, facilities and program development. For example, if one of the branches were having trouble with their respective landlord, the facilities office would provide advice on how to handle the situation. Each branch was responsible for managing its own operations and worked closely with their respective board to evaluate community needs, set the annual operating budget, rally resources to support the

branch and assess branch success. For commitments over \$200,000, a formal presentation to the General Board was typically required.

Walker had worked for the YMCA for over 23 years. Her role was to support and supervise branch success, program growth and new initiatives. She did so by analyzing monthly management reports and by meeting with District Vice Presidents and with Executive Directors on a one-to-one basis. Walker also held operations meetings for all branch executives hosted by a different YMCA each month. All heads of the administrative functions within the corporate office were invited to the meetings to provide additional support to branches.

### **Strategic Planning in the 1990's**

In 1995, The YMCA of Greater Boston General Board, with input from branch boards and supported by staff, initiated a strategic planning campaign called Focus 2000. The five-year plan provided a vision for the future with goals, standards of achievement and strategic objectives, which were consistent with the emerging environment of metropolitan Boston (See Exhibit 2 for details of the strategic plan). Each October, Executive Directors developed written annual branch plans and set operational and financial goals for their respective branch for the upcoming year. Branch plans were tied directly to the goals set forth by the strategic planning program and were reviewed by members of the executive team.

One of the key elements of Focus 2000 was the notion of the ten-minute ride. The goal was to have a branch or program center within a 10-minute ride of all families of Greater Boston and to provide programs and services closer to where people lived. There were two key methods for achieving this goal. One was through the development of extension sites. Another was to approach independent YMCAs in the greater Boston area. Independent YMCA's such as Charlestown and Cambridge operated one facility in their respective community and were not part of a larger corporate YMCA. As part of the strategic planning process Ferrell and Walker pinpointed the neighborhoods that were serviced by the YMCA and those that were underserved.

A launch team investigated three key underserved areas of greater Boston: South Boston, Charlestown and East Boston. The YMCA conducted focus groups in each of the areas and East Boston showed the greatest interest and need. According to a study by the United Way, East Boston was a growing section of Boston in need of community programs. The YMCA decided to initiate the development of an active family center, which would include fitness as well as interactive children's activities.

### **Getting Acquainted with East Boston**

After reviewing the needs assessment conducted by the United Way, there were a number of steps taken to get a "hands-on" impression of East Boston. Among the steps taken were Ferrell and Walker spending time in the community observing the culture and demographics. Walker commented:

We rode around the community with police officers and met with community leaders to learn as much as we could about East Boston. What really struck me on one day was the vision and community involvement expressed. There was a real sense of commitment and betterment; it was inspiring.

The process confirmed that East Boston was a diverse neighborhood and home to many immigrants. In recent years, a large Hispanic population had emerged representing 39% of the population. East Boston was home to Logan International Airport, one of the nation's busiest airports. Trash lined the streets and homes were in need of repair but despite this, the community appeared to be growing rapidly with immigrants from South and Central America, Southeast Asia, Haiti and Eastern Europe.

Walker hired Kathy Lozano, Director of New Program Development, to conduct a thorough investigation on East Boston and to report on the community's needs. Lozano spent several months meeting with community leaders, existing agencies, school principals, merchants, realtors and residents in East Boston to help determine what the YMCA could accomplish within



the community. She also looked around to find potential space where the YMCA might locate programs and facilities. Most importantly, her goal was to determine if the YMCA would be well received. Lozano's findings indicated that there was a clear need for YMCA programs particularly in the following areas: childcare, immigrant services, ESL, job training and physical fitness.

Childcare appeared to be the greatest need. Lozano learned that a recent survey conducted by the Parents United for Child Care, found that 600 children could be receiving childcare if there were programs available. The survey also found that there was only one licensed infant day care provider in East Boston, and that there were 200 names on the waiting list. There was a clear need for quality licensed childcare programs, particularly within the minority community and for non-traditional hours of operations. She also learned that there were 14 school age programs, only half of which were licensed.

It was clear that childcare was a huge opportunity for the YMCA in East Boston. Lozano began working on securing state-funded<sup>172</sup> slots for 14 toddlers, 10 pre-schoolers and 10 school age children. The YMCA of Greater Boston already had several hundred contracts with the OCC for childcare slots to support its other childcare programs. To obtain additional slots for East Boston, a request to expand slots was necessary.

As Lozano completed the development study, she decided to leave the YMCA of Greater Boston for another YMCA job opportunity in Chicago. Walker needed to find a program director who would launch the new facility. Walker targeted to Wendy Zinn, a staff member who had been climbing the ranks within the Central Branch (See Exhibit 3 for the program director job description).

### **Wendy Zinn**

Wendy Zinn graduated from Northeastern University (NU) in 1990 with a Bachelor of Science degree in recreation management. While at NU she worked as a marketing coop student at the

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<sup>172</sup> State funded slots were offered through the Office of Childcare Services. These are contracts that enable non-profits such as the YMCA to offer childcare to low-income families within the City of Boston. The YMCA of Greater Boston applied for state funded slots which were granted to families based on their income levels. The YMCA managed the slots on behalf of the families.

YMCA of Greater Boston, located adjacent to NU. After graduation, she accepted a full-time position as an associate director of communications. Zinn commented:

I was intrigued by the culture of the YMCA and I valued their commitment to the mission and values of honesty, respect, responsibility and caring. I also liked the diversity of the organization – everyone is from different backgrounds and cultures and it is a truly nondiscriminatory environment. I wanted to be a part of this community that was committed to changing the lives of others.

In 1991, the YMCA was affected by deteriorating economic conditions and was forced to reduce its workforce. Zinn was transferred to the position of Membership Director of the Central Branch where she was challenged with increasing membership enrollment. As she grew in this role, Zinn became the central point of contact to all members, ensuring they were happy and attracting new members. Membership doubled from 1991 to 1998 and within this time, Zinn was promoted to Senior Program Director of Membership and Marketing. Edward Connelly, a longtime member of the YMCA commented on Zinn:

When I first met Wendy, she was quite green. She was just starting out at the YMCA and I was immediately drawn by her tenacity and desire to succeed. She's a bright, hardworking individual who always takes the time to listen before she acts and no matter what the situation is – she always keeps her cool. She also treats everyone around her fairly. Whether you were a high or low level employee, Wendy does not make a distinction.

Also in 1991, Zinn married William Zinn and four years later, the couple gave birth to their first and only child. Zinn used the YMCA's childcare which enabled her to be close to her daughter while she worked long hours. In 1995, Zinn began to pursue a master's degree in Human and Social Services while continuing to work full-time. Classes were offered at the Central Branch, making the process easier. Zinn won the Outstanding Achievement Award in 1995 and again in 1999 for her hard work and dedication to serving the YMCA and its community.

In her tenure at the YMCA, Zinn took advantage of the career development programs the YMCA of the USA and the YMCA of Greater Boston had offered. Zinn had been one of five staff members who had been identified by senior staff to attend and the Executive Development program offered by the YMCA of the USA. Career development was a key element of the management philosophy of the YMCA of Greater Boston and went to great lengths to develop managers from within and move people up through the system. Joe Nogelo, a District Vice President of the YMCA of Greater Boston commented on career development, "The YMCA is national and international - unlike many non-profits, there is great mobility, especially for people who are willing to relocate for a better opportunity."

After Zinn completed her master's degree program in 1998, she was ready for a change. Zinn was approached by Walker to discuss her future at the YMCA. Walker saw Zinn's potential. Walker commented:

Although she was had no prior experience with childcare, I offered Wendy the position of Program Director of East Boston. Wendy had been successful in her position and had been part of the revitalization of the Central Branch. She had earned respect of colleagues and members and she was ready for a change. The Springfield Master's program made her hungry to put into practice the community development methods she learned in the program. I trusted Wendy and knew she operated with integrity, had initiative, and had a strong communication style.

Zinn reflected on taking the new position:

This was an incredible opportunity for me but I was a bit nervous about taking the job. There was no one to take over responsibilities for my old position, which had long been considered a "cash cow" operation for the Central Branch. I was also leaving a boss I adored to go off to a job without really knowing what it entailed. Also, I had no staff and I didn't have enough qualifications to work with children. On top of that, I had never even been to East Boston except to go to the airport!

## **Starting Up the East Boston Branch**

Through the YMCA's capital campaign, Zinn received \$250,000 in private and public funding for the East Boston program which came in the form of grants from major corporations such as State Street Bank and Cabot Corporation, both of which had ties to the community. With these funds and strong support from the corporate office, Zinn set out to establish YMCA programs in East Boston.

### **After-school Centers**

While continuing to work out of her office at Huntington Avenue, Zinn sought out community centers in East Boston to run after-school programs. The purpose of the after-school programs was to provide support for working families who couldn't be home with their children. The Umana Barnes Middle School closed at 1:30 p.m. and became a city run community center at night from 2pm –10pm. The community center director was willing to allow the YMCA to use their facility at no charge to run an after-school program for 26 children age five to twelve.

Once the Umana site was secured, Zinn needed to hire a qualified childcare director. Lozano had placed an ad in the paper for a director, allowing Zinn to narrow the field quickly. She hired Deirdre Madden, a licensed childcare worker who had worked for several years in South America. Since Madden had experience in childcare, she was familiar with licensing procedures. On her first day on the job, Madden and Zinn set out to get licensed through the Massachusetts Office of Childcare Services.

Although the YMCA of Greater Boston operated branches that were already running childcare programs, each community had different needs and branches and program centers had to tailor their operating strategy accordingly. Zinn tapped into several of the resources provided by the metropolitan offices and contacted her colleagues at other YMCAs to get answers to her questions and to seek moral support. Quickly Zinn learned the childcare policies the YMCA had developed. One of the major policies was the "Child Abuse Prevention Policy," which stated that a worker could not be left alone with a child. In order to adhere to this policy, Wendy needed to hire a second person. Zinn hired Gladys Martinez, a Latina from East Boston, so there

would always be two staff members in the room when the center was opened and so Zinn could focus her efforts on program development.

In January 1999, the after-school program at the Umana School opened. Zinn had placed an ad in the local paper to publicize the new program and announced an open house at the school. By the end of the one-hour open house, all 26 slots were filled.

### **YMCA of East Boston Program Center**

Finding space for the toddler and preschool programs was critical. Lozano had already found a building for the East Boston Program Center. The program center was scheduled to open in March 1999 and was located on 944 Bennington Street in the Orient Heights neighborhood. The building, which would be leased and renovated, was approximately 4,400 square feet. Since the building was abandoned, rent was negotiated at \$4 per square foot. The building had to be completely gutted and needed new flooring, walls and windows to brighten up the rooms.

To determine how the center would be organized, Zinn looked at YMCA childcare facilities at other locations. While she couldn't afford all of the equipment other YMCAs had, she got a sense of the necessities and pieced together how they wanted it to look. Zinn received support from the corporate office, including the oversight of construction by the facilities department and from Walker who was instrumental in negotiating the lease terms.

### **Finding the Right Team**

As she worked to open the Program Center, Zinn conducted a search for teachers. After interviewing several candidates at the adjacent Burger King, Zinn convinced Suzanne Bennett, her daughter's preschool teacher at the West Roxbury YMCA, to come to East Boston as a Head Teacher. Bennett commented on her decision to join Zinn:

Every day when Wendy came to school to pick up Carly, she would ask me questions about the daycare program at West Roxbury. She told me about the East Boston facility and I enjoyed giving her ideas on how she should arrange the classrooms and items she needed to purchase. Carly's teacher-parent conference turned into an interview for a job.

In January 1999, I came to work for Wendy. It was strange for me because the building renovations were not complete so we had no base. Wendy's enthusiasm kept me going. She encouraged me to get involved in meetings with the property and business managers and I assisted her in interviewing other teachers.

Zinn needed to hire a school age director to supervise the after-school program so that Madden could lead the toddler and preschool program. Zinn offered the job to Ed Escobar, an immigrant from Puerto Rico, whom she had known since 1991 from the Central Branch and lived in East Boston. Escobar had started out as a janitor at the Central Branch and eventually became Service Desk Manager and later Aquatics Director. Escobar was thrilled to work with Zinn again. Escobar remarked:

Wendy is like a sister to me. She is always pushing me to achieve more. Wendy has always seen the potential in other people. She's like a mother hen and takes you under her wings. She encouraged me to go to college and take courses to develop my computer and writing skills. Wendy and I are a great team and I was looking forward to working with her again.

According to Zinn:

Ed was the first man to join the East Boston branch. Ed had school age children of his own and he has been a positive male role model to many of the children – particularly to those children who came from single parent homes. Ed worked closely with Gladys and together, they were able to better serve the children and parents of which 80% were Spanish speaking.

Zinn also hired Gail Klimas as a lead teacher for the toddler program. She had experience with home daycare, and had worked with special needs children. Klimas was delighted to work in a facility where she could bring her own children and could benefit from the YMCA services.

Most of the other staff members Zinn hired had worked at other agencies in East Boston. They were thrilled at the opportunity to work at the YMCA because it offered better pay and benefits and provided greater job security (See Exhibit 4 for an organization chart for the YMCA of East Boston).

### **Program Center Opening**

Six weeks prior to the opening set for March 1999, Zinn and her team met with interested parents at the Burger King. Burger King was used as a meeting place to familiarize parents with the future location of the program center and because there was no other YMCA space available in East Boston. Zinn had openings for 48 children which filled up the first night. The opening of the program center was delayed by two months, opening in May 1999. The facility had three classrooms. Two of the rooms held the 18 toddlers and other room was used for the 30 preschoolers. Zinn commented:

The community response toward the YMCA was overwhelming. I was surprised that many families were so desperate for childcare that they were putting their money into a program that wasn't completed and had not yet established credibility in the community. I attribute that to the strong YMCA brand and mission.

### **The Growth Years**

By the end of 1999, East Boston had met an overwhelming need for childcare in the community. Three school age childcare programs opened in schools, serving over 115 children from East Boston and its surrounding neighborhoods. More than 80 children were on the waiting list. In 2000, the YMCA of East Boston had met and exceeded the goals set forth by the Focus 2000 strategic plan. Nearly all of the parents needed financial resources to help pay for childcare costs and the YMCA was able to meet those needs through its aggressive pursuit of state funded slots.

By 2000, Zinn operated seven childcare sites and her staff had doubled. She was applying for and receiving large grants, which enabled her to expand to existing sites. Zinn received two \$75,000 grants to open two more sites to serve teens. Zinn also obtained a \$20,000 grant to start an after-school program in the North End at the Elliott school. In addition, Zinn accepted the challenge to assume supervision of an existing YMCA daycare program at the South Boston Courthouse.

Zinn actively recruited individuals to serve on the YMCA of East Boston Board of Managers. She read the local paper and sought out the prominent members of the community. Zinn put together a list of 20 names, which included educators, senior community and religious leaders, lawyers and business people. Her goal was to have a board that represented the diversity of the community. Zinn successfully recruited people like Derek Brodin, who was the community liaison for Massport<sup>173</sup>. Brodin and other board members provided further connections for the YMCA into the East Boston community.

Zinn, and through her encouragement, her staff, became involved in every aspect of the community. She regularly visited the Chamber of Commerce, the East Boston Police, Massport and other prominent organizations in the East Boston area to enlist support. Zinn actively participated in community events and attended Healthy Boston meetings. The Healthy Boston Coalition was a consortium of residents, educators, service providers, religious groups and business people which worked together to develop programs that improve the health, safety, and cohesiveness of the neighborhoods of Boston. Zinn worked to build relationships with staff from community centers with an intention to partner with other non-profit organizations in East Boston, share resources and sponsor events together. According to Ed Escobar:

Wendy got me involved with everything. I attended several community meetings and on Saturdays, I work for the community teaching teenagers to be lifeguards. When I walk into a grocery store, someone always recognizes me and that makes me feel as though I am really contributing to the East Boston community.

Gail Klimas, who had been promoted to Childcare Director in August 2000, noted:

Wendy encouraged me to go out and really get to know the community. We volunteered at many different community events and served on several committees. Any invitation we receive, we go. I really enjoy this aspect of my job because I am always meeting new people and its great PR for the YMCA.

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<sup>173</sup> Massport (Massachusetts Port Authority) is an independent public authority responsible for the development, promotion and management of airports, seaports and other transportation infrastructure in Massachusetts and New England.



In September of 2000, the YMCA of East Boston became an official branch of the YMCA of Greater Boston. A branch was a standard operating unit that was geographically independent with a budget large enough to sustain itself long-term. The key elements in becoming a branch included a strong board made up of community leaders and fundraising capabilities. As a result of this transition, Zinn was promoted to Executive Director. Walker commented on the decision to upgrade East Boston into a Branch:

Some sites never evolve into branches. To qualify as a branch the programs need an infrastructure which needs to be supported both organizationally and financially. Wendy was able to get East Boston to a point where it became geographically independent and in a short period of time, was able to build a big enough budget that could support long-term growth.

### **Growing Pains**

In the fall 2001, Zinn had two serious issues on her plate. Zinn reflected:

I was having difficulty sleeping at night and was under great stress. The North End facility had not achieved the level of participation expected and was not profitable. Also at this time, I was having difficulty with the South Boston site. The site was too large to manage and the parents in South Boston were unbelievably controlling. There was a much bigger opportunity in East Boston and that's where I wanted to focus my energy.

Zinn made the difficult decision to shut down the facility in the North End. She made a concerted effort to place each of the children at the YMCA's other sites in Boston. The situation at South Boston had escalated to senior management. Once the decision had been made to give up the site, Zinn worked closely with Walker to transfer ownership of the South Boston site to another daycare provider. With these two matters put to rest, Zinn focused her energy on managing the growing needs of East Boston.

Another major challenge Zinn faced was the financial constraints of parents. Most of the parents in need of childcare were low income and therefore required financial assistance. The YMCA's policy was to not turn a family away if they couldn't afford to pay. The YMCA of East Boston

was paying out \$250,000 in financial assistance to parents to fund 50% of their childcare expenses (See Exhibit 5 for the operating budget).

By early 2002, Zinn and each of her department heads noted that space was their most significant problem. Most of the staff did not have their own offices and because they didn't own the facilities used for after-school programs, there was no place to leave equipment such as educational material, games and toys. Given the strong demand for childcare services, there was the potential to expand all of the programs but each of the current sites were fully utilized.

### **The Boston & Albany Engine House**

Zinn had been working closely with Ferrell and Walker to find a property where they could expand the childcare programs and offer more traditional services such as physical fitness, sports and adult education. After a long and difficult search, they set their sights on the Boston & Albany Engine House.

In November 2001, the Massachusetts Turnpike Authority (MTA) had put out a Request for Proposal for the Boston & Albany Engine House located on Bremen Street in East Boston. The Engine House and surrounding property had been acquired by the MTA under the Central Artery Tunnel Project in connection with highway and park construction in East Boston. The MTA was looking for a community agency that could adhere to the following:

1. Conceive and carry out a development that is appropriate to the historic character and future park and community setting of the building;
2. Demonstrate the experience and capacity necessary to implement a project of this scale involving intense community interest and involvement; and
3. Respond to City of Boston zoning and reuse guidelines developed in conjunction with the East Boston community.

The Engine House was built in 1909 and was a single story brick building with 9800 square feet. The property had been deemed "historically significant" as it was one of the few remaining

railroad facilities from its era. Rehabilitation of the building would require preservation of significant features of the property and would be subject to review by state historic agencies. The building would be surrounded by a new public park, which was being constructed under the Central Artery Tunnel Project and the East Boston Greenway. In planning for the reconstruction of the building, the East Boston community had expressed strong interest in a community-oriented use related to the new park.

### **The Decision**

Zinn was confident that a full service facility would be welcome in East Boston. Since opening day in May 1999, she had been bombarded with phone calls from parents and community members asking about the pool hours or inquiring on membership costs. Also, it was believed that the East Boston was an “up and coming” neighborhood. Luxury condominiums were being built which would likely attract a higher clientele to the YMCA. Zinn still wondered whether the YMCA would be able to attract members if the facility did not have a pool and full-court gymnasium.

In April 2002, the YMCA hired an external consultant to prepare a detailed needs assessment to determine how prospective members’ would react to a new YMCA in East Boston, assess interest in membership, understand the importance of possible programs and services, and determine membership pricing. Key findings of the study suggested that an overwhelming 88% of residents of East Boston and nearby communities believed that the renovation of the Engine House to a YMCA was desirable. The study further revealed the following pricing and membership expectations:

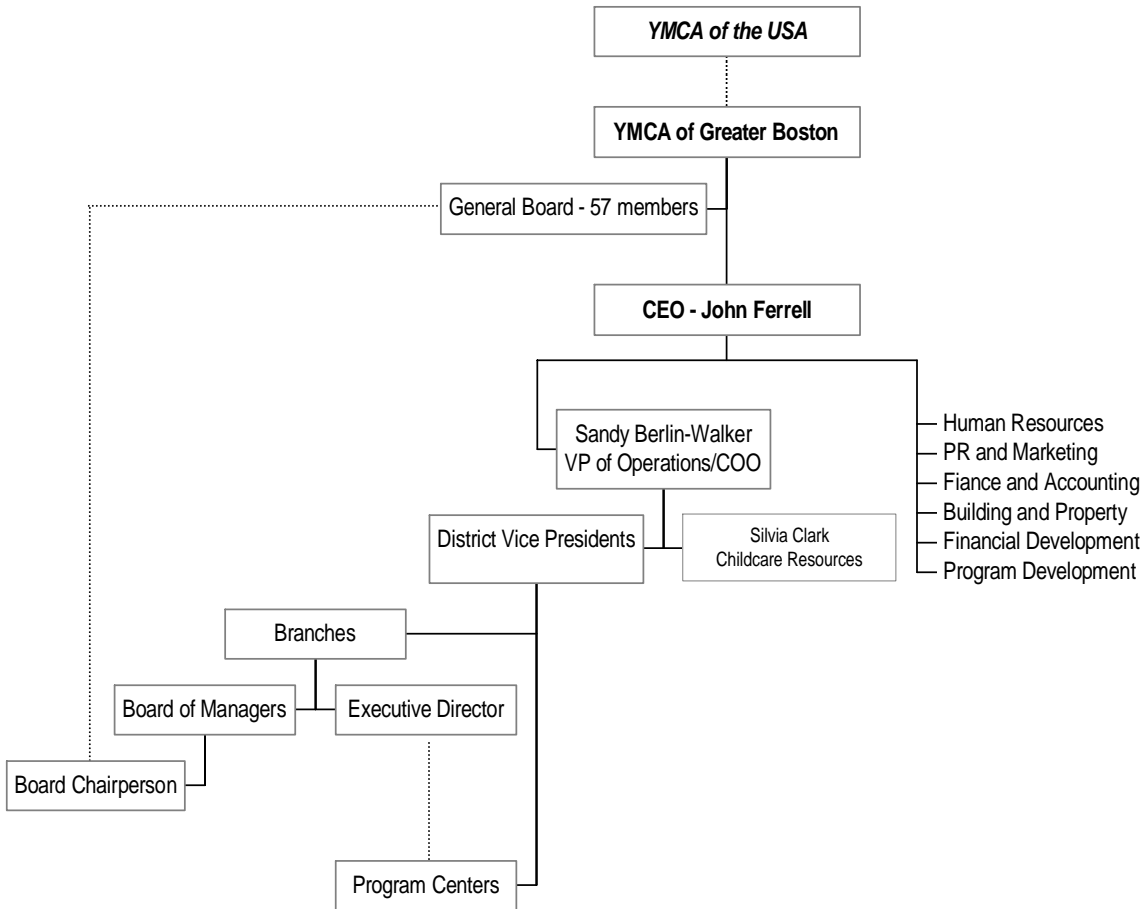
	<b>Estimated Monthly Membership Fees</b>	<b>Membership Units Attracted Per Year</b>
YMCA with <b>no</b> Pool and Full Court Gymnasium	Family: \$52 Individual: \$35	2,730 family 1,238 individual
YMCA with Pool and	Family: \$52	5,023 family

Full Court Gymnasium	Individual: \$35	2,732 individual
YMCA with Pool and Full Court Gymnasium	Family: \$48 Individual: \$30	5,569 family 3,263 individual

Zinn believed that the findings of the study were overly optimistic. She had done her own analysis and compared the numbers of family memberships at other YMCA branches in Boston. Zinn found that family memberships at other locations were only half the number suggested in the study and these branches were operating full facilities with a pool and gymnasium. Although the neighborhood was changing, there was still a huge population that would not be able to afford membership fees and would required financial assistance from the YMCA.

Ferrell and Walker were convinced that East Boston was a neighborhood in tremendous need of additional YMCA community programs and services and were willing to make a substantial investment in the development of a new facility. The two were also enthusiastic about the Engine House location. After all, it wasn't everyday when a nonprofit organization won an RFP to acquire a building. However, it was still unclear as to whether the \$5 million investment would be financially sustainable in the long run.

**Exhibit 1: YMCA of Greater Boston Organization Chart**



**Note: The branch board chairperson had voting privileges on the general board**

## Exhibit 2: Strategic Plan

The plan centered on the following vision for the Year 2000:

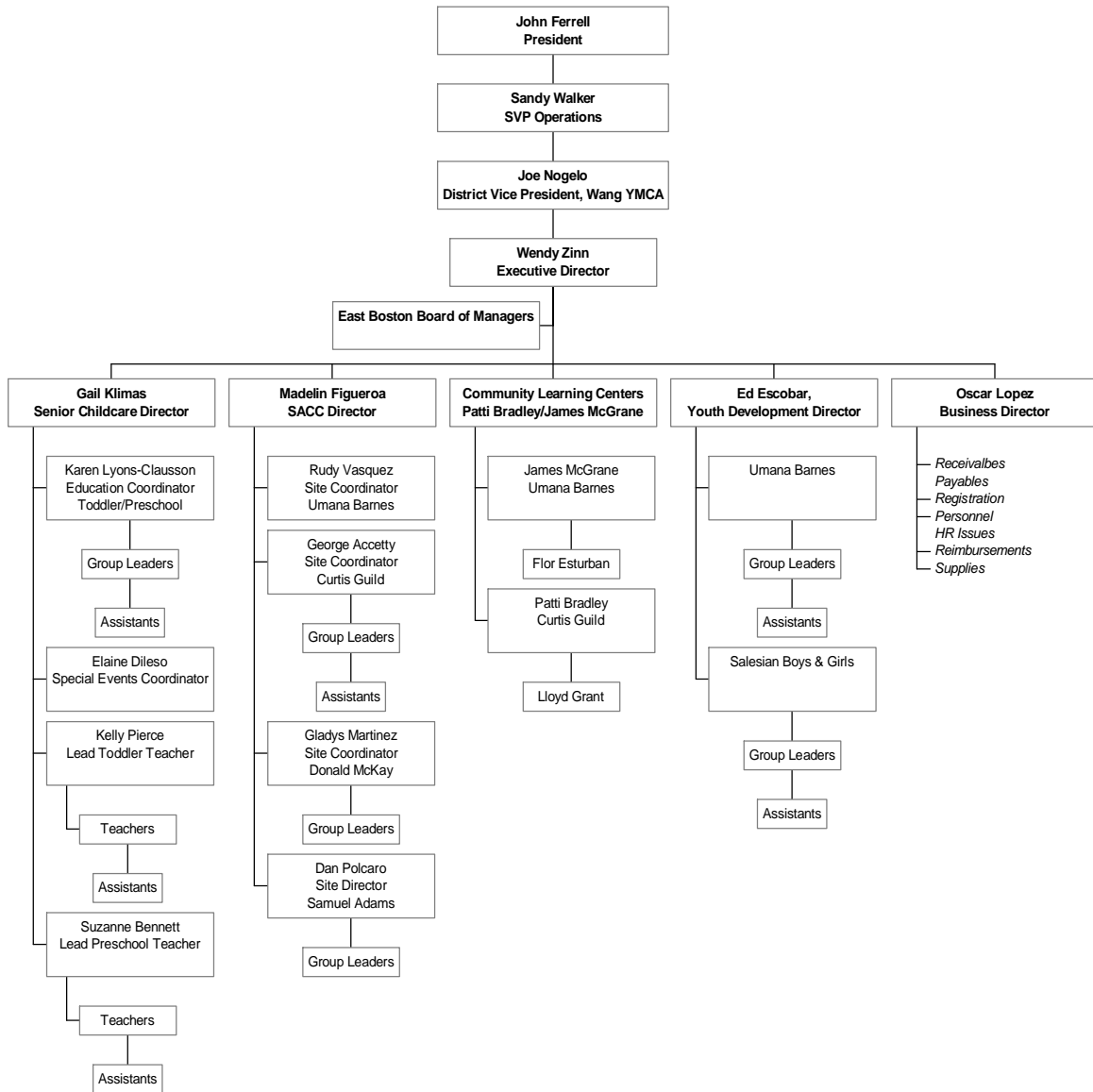
The YMCA of Greater Boston is a unique, community-supported organization dedicated to improving the quality of life for families and communities through its programs, services, and facilities in the diverse neighborhoods and towns of metropolitan Boston.

- By the Year 2000, the YMCA will double its current constituency, including 120,000 members, program participants and volunteers in the Y family.
- Programs and services will be offered through a coordinated network of easily accessible facilities and program centers within a ten-minute ride of every family in metropolitan Boston.
- Serving on the YMCA General Board will be viewed as one of the premier opportunities for community service by corporate and community leaders.
- The organization will be supported by substantially increased capital and operating resources, new corporate partnerships and community collaborations, and strengthened internal capacity to support, measure and communicate the quality.
- Program services for financially challenged communities that will be strengthened through a regional approach to development throughout the greater Boston area.

To expedite this vision, the YMCA developed five key strategies:

1. **Support families.** Families will be the priority constituency for the YMCA of Greater Boston through the year 2000. Program and facility development and marketing activities will focus on activities that provide family support and enrichment, education and life skills, wellness and personal fitness.
2. **Reposition the YMCA.** Aggressively reposition the YMCA as the pre-eminent community service organization in Greater Boston serving families.
3. **Expand Program Center Network.** Develop a strategically placed network of high quality program centers, including full-service Y branches, active family centers, and childcare/youth development centers, with at least one center within a 10-minute ride of every family in metropolitan Boston. See Exhibit for Map of Current branches and proposed expansion sites.
4. **Pursue partnerships, alliances, collaborations, and mergers.** Enter into corporate partnership, strategic alliances, community collaborations, and mergers to expand resources, broaden public understanding, and increase the YMCA's ability to reach diverse communities.
5. **Increase net operating revenue.** Increase net operating revenues to 3% of total revenues annually by the year 2000 through program and facility expansion, membership growth, and increased contributed income. Re-invest in program innovations, capital improvements, deferred maintenance, and funded depreciation.

### Exhibit 3: East Boston Branch Organization Chart



## **Exhibit 4: Program Director Job Description**

### **YMCA of Greater Boston**

Position Title: Program Director

Reports to: Director of Program Center Development

Date: 8/98

#### **General Function:**

Develop and implement programs within the community of East Boston. Focus on fostering cooperation and collaboration with a range of community based groups and organizations. Supervises existing YMCA programs within East Boston while striving to expand the numbers of families from East Boston who will be served by a YMCA program. Possesses a commitment to program growth, an enthusiasm for building coalitions, creative problem solving experience and enthusiasm.

#### **Know How:**

1. Must have and utilize excellent organizational skills.
2. Must have excellent human relations to facilitate positive relationships with children, parents, staff and community organizations.
3. Must be committed to carry out the mission and goals of the YMCA.
4. 2-5 years creative program development experience.
5. Basic safety certifications

#### **Responsibilities:**

- Supervise and maintain program consistent with the YMCA mission and philosophy
- Responsible for the oversight and daily operation of school age child care programs that abide by Office for Child Care Services regulations.
- Create and maintain a minimum of two Earth Services Corps. Clubs for middle and high school age youth.
- Work with other YMCA branches and community based organizations to provide programs for senior citizens.
- Collaborate with the YMCA International Learning Center to establish English as a Second Language (ESL) classes.
- Responsible for the creation and monitoring of program budgets.
- Communicate the goals and objectives of YMCA programs to the community.
- Responsible for recruitment, hiring, and orientation for program staff and volunteers. Ensure effective communication and supervision.
- Maintain program enrollments.
- Perform other duties as requested by supervisor.

#### **Effect on End Result:**

1. Programs which meet the needs of the community in a manner consistent with the mission of the YMCA.



2. Fiscally sound programs which meet the stated enrollment/staffing levels.
3. Positive relationships with existing service providers, resulting in truly beneficial collaborations and partnerships.

**Exhibit 5: East Boston Income Statement - 1999-2002**

	<u>1999</u> <u>Actual</u>	<u>2000</u> <u>Actual</u>	<u>2001</u> <u>Actual</u>	<u>2002</u> <u>(Budgeted)</u>
<b>Revenue</b>				
Contributions	20,000	39,750	71,901	47,878
Local United Way	1,000	6,000	12,000	22,000
Fees/Gov't Grants	180,950	448,171	605,282	988,339
Program/Parent Fees	221,210	221,043	962,282	294,359
Other	-	2,797	3,470	4,642
<b>Revenue Totals</b>	<b>423,160</b>	<b>717,761</b>	<b>1,654,935</b>	<b>1,438,019</b>
<b>Expenses</b>				
Salaries	258,846	439,998	1,024,889	858,209
Employee Benefits	20,266	39,167	99,139	145,377
Payroll Taxes	28,865	48,305	114,276	93,942
Professional Fees		2,000	7,900	5,500
Supplies	12,888	45,162	98,010	73,775
Telephone	1,802	6,360	12,960	15,600
Postage	895	720	1,020	825
Occupancy	55,919	57,048	82,988	73,336
Positioning/Communications	2,200	675	2,225	2,350
Transportation	5,346	-	-	12,900
Travel/Training	1,075	3,300	7,754	6,450
Subscriptions		-	-	-
Insurance Premiums	5,564	3,406	6,672	10,008
Corporate Services	46,115	81,736	180,738	162,962
Other	4,746	10,438	16,480	4,440
<b>Expense Totals</b>	<b>444,527</b>	<b>738,315</b>	<b>1,655,051</b>	<b>1,461,144</b>
<b>Net Surplus/Deficit</b>	<b>(21,367)</b>	<b>(20,554)</b>	<b>(116)</b>	<b>(23,125)</b>

**Notes:**

Contributions are private funding sources.

Local United Way is funding received by the United Way foundation.

Fees/Grants and Gov't refer to childcare slots funded by the Office of Childcare Services.

2002 Revenues declined as a result of the closing of the North End and South Boston programs.

## Teaching Note

### Case Synopsis:

Following a strategic planning process, the YMCA of Greater Boston's executives decided to expand into East Boston, an economically diverse and challenged neighborhood adjacent to Logan International Airport. In early 1999, the executives selected Wendy Zinn, a decade-long employee of the organization with a record of turning-around units that she led, to serve as director of the new program. By 2002, Zinn had harnessed the community's overwhelming need for services such as childcare and after-school programs into a thriving YMCA branch. Zinn's success could also be measured in money raised: in 1999 she secured \$49,050 in grants and by 2001 she won \$358,742 in grant monies.

Success brought a new set of problems: space for existing programs was limited and future growth would not only require additional space but also a significant amount of financial resources. As Zinn grappled with these problems, the Massachusetts Turnpike Authority (MBTA) issued a Request for Proposal (RFP) for its Boston & Albany Engine House in East Boston. While the Engine House property was centrally located and near public transportation, the property could not accommodate the building of a pool nor full-court gymnasium, facilities usually found in YMCA branches. Further complicating matters, renovating the Engine House within the required historic guidelines would be expensive and it was expected that a large percentage of potential members in the community would require subsidies to join the Y. Finding adequate space within the East Boston community had been a challenge in the past and the Engine House was likely to be the only affordable option for expansion of the East Boston Branch. Additionally, there was a strong likelihood that if submitted, the Y proposal would be accepted by the MBTA. Given these considerations, Zinn and her bosses needed to decide whether or not the Y should submit a proposal to the MBTA for the Engine House and to analyze the risks.

### Intended audience and case positioning:

This case was written for the beginning part of a second required course in organization behavior in a MBA program. The second course, *Leading Organizations*, focuses on developing and changing organizations. In the first course, the MBA students have acquired a working knowledge of Kouzes & Posner (2002)'s model of leadership, as set forth in their book *The Leadership Challenge*. It is this framework of leadership that under girds the discussion of Zinn's leadership at the East Boston YMCA.

A major purpose of the *Leading Organizations* course is for students to examine what are universal truths about organizations and what differentiates one type of organization from one another. For example, students are asked to articulate the similarities and differences between profit-making and non-profit organizations. To draw these distinctions, the authors begin the course with a case about growing an entrepreneurial venture. Any number of cases can set the stage by describing important activities such as raising capital, hiring first employees, and providing quality goods and/or services. Following an entrepreneurial case with the East Boston Y case encourages students to see how funding differs and yet leadership behaviors are similar;

and how relationships between and among people, such as employees and advisors, are both similar and different.

A second purpose of the course is for students to analyze how to change organizations. Duck (2001)'s *The Change Monster* is the change management framework used. Duck argues that change occurs in all organizations in predictable stages of stagnation, preparation, implementation, determination, and ultimately fruition (pp. 16-17). From an assigned reading, students have been introduced to this "Change Curve." More importantly, Duck has opened the conversation about the importance of the range of human emotions - engagement, anger, joy, frustration - in organizational life. Duck's Change Curve, particularly her early stages of stagnation and preparation, encourage students to think how the YMCA of Greater Boston is not falling into stagnation, but rather moving itself forward with its investment in East Boston and the development of another branch in an underserved community.

Zinn's rapid growth of the East Boston program into a branch invites a comparison to starting a franchise rather than a new non-profit. Hummel (2002) gave an exhaustive list of activities to get a nonprofit up-and-running. However, Zinn's start-up phase was different. Like a well-established for-profit franchise, the YMCA of Greater Boston offered Zinn a respected reputation and brand name, plans for development, linkage to state resources, and people to support her. While there are any number of articles and books on franchising, there are several web sites on the topic that can be fun for students to examine (see list under **References**). Comparing the start-up of the East Boston Y to a franchise opens up an interesting conversation.

### **Research Methodology:**

The authors spent two days conducting field research. The first day was spent at the East Boston YMCA interviewing Zinn, her direct reports, and observing the childcare programs. We spent a second day at the Central YMCA headquarters in Boston, interviewing people up the chain of command from Zinn and other people who had direct input into the development of the East Boston Y. In total we conducted 8 in-depth interviews and observed the childcare program and activities at the Y's headquarters in Boston.

All interviews were tape-recorded with the permission of interviewees. Once we had a draft of the case, interviewees were asked to approve the use of their quotes in the case. Zinn and YMCA of Greater Boston executives approved the use of the case for classroom purposes.

### **Teaching Objectives:**

- To illustrate the support and resources that a traditional non-profit organization invests in a new program and the impact of the new program on both the "parent" and "child" organizations;
- To analyze how a leader grows and develops a new program in an economically diverse community; and

- To examine the dilemma that the YMCA of Greater Boston leaders now face: what level of funding does it allocate to the East Boston Y; and how does it make this investment decision.

## Teaching Plan

The following plan is for a ninety-minute class. There are three primary discussion blocks that evolve from the three teaching objectives listed above.

Study questions:

1. Do you think that it is more appropriate to view Zinn as a social entrepreneur or a social franchisee? What data from the case supports your view?
2. What leadership behaviors did Zinn exhibit as she grew the East Boston YMCA?
3. Should Zinn recommend for or against the development of the Engine House for her East Boston branch? Why did you select your option?

Note: If you need to refine your definition of franchising, go to one of the following websites: [www.rightonthemoney.org](http://www.rightonthemoney.org), [www.franchise.org](http://www.franchise.org), or [www.franchiseresearch.com](http://www.franchiseresearch.com)

## Discussion questions and answers:

### I. *Growing and expanding the reach and services of the YMCA of Greater Boston:*

- A. How did Ferrell and Walker, the President and Senior Vice President of the YMCA of Greater Boston, decide to expand into East Boston?

Ferrell and Walker led their organization through a thoughtful strategic planning process. They used the “10 Minute Ride” approach to figure out where the Greater Boston Y might expand. This process led them to seriously consider three neighborhoods in Boston: Charlestown, East Boston and South Boston. As the Y sent representatives into the different communities, it was the East Boston community that seemed most receptive to a new program by the Y. Poking around in the community revealed the overwhelming need for quality childcare programs.

- B. Walker picked Wendy Zinn, someone who was *not* a licensed childcare administrator, to lead a start-up childcare program in East Boston. What do you think were the advantages of selecting someone without that credential? What were the disadvantages?

If we assume that East Boston is analogous to a franchise situation, then Zinn knew the ins-and-outs of the Y, its systems, and people. She was also a proven leader within the Y community, receiving the Outstanding Achievement Award in 1995 and again in 1999. Being able to operate effectively within the Y and know how to recruit valuable Y employees were critical skills for Zinn. On the other hand, Walker was taking some risk with Zinn. Since Zinn was not a licensed childcare administrator, she had a steep learning curve on childcare programs. In addition, because of YMCA policies regarding the number of adults required to be left alone with a child, Walker had to commit to hiring at least two childcare administrators in addition to Zinn .

Zinn had several years of experience in building community support as a result of previous positions she had held within the YMCA of Greater Boston. While she had not specifically run childcare facilities, she developed and ran several other community programs. Walker was clever in selecting a leader who knew the business of the Y but was not professionally committed to childcare. Since Zinn had to hire someone to run the childcare programs, she had to take a big picture perspective of the East Boston program.

- C. Overall, how would you assess the level of risk that the Greater Boston Y assumed in starting up the East Boston program?

The Y went into the East Boston community slowly, carefully, and thoughtfully. (This approach is consistent with Duck's notion of going slow at the beginning to go fast with a change effort in the later stages). The executives of the Y began by examining three communities, thereby enabling themselves to compare and contrast responses from the communities. They examined data, such as the need for childcare programs. They made many contacts with community and political leaders. A development person hired by the Y further laid the foundation for relationship building and networks and for finding space and people. The slow, methodical process minimized the risks, as did the lack of competitors for childcare services in the community.

## ***II. Growing and building the East Boston Program***

- A. Zinn has been extraordinarily successful in growing the program in East Boston. What do you think were the key factors that led to her success to date?

She had a capacity to evaluate people, see their strengths, and then to recruit them to work for her. Once she had good people on her staff she

motivated and encouraged them to grow and develop. These strong relationship-building skills also served her well in the community. Quickly, Zinn identified and built an advisory board among the leaders of the East Boston Community. This same ability to connect with people served her well with her relationships with people at the Y headquarters in Boston. All in all, Zinn shows herself to be a strong leader of people.

In discussing this case, a few students inevitably note that Zinn exemplifies many of the leadership behaviors that Kouzes and Posner advocate. She enables others, encourages the heart, models the way and creates a shared vision. While it is not clear from the case if she “challenges the process,” it is very clear from the case that she engages the process and wins!

- B. Zinn has made her share of mistakes in leading the East Boston Program. Two come quickly to mind: the North End After School Program that she opened and then closed due to low enrollment and the Childcare Facility at the Federal Courthouse that the Y yielded to a competitor. Why do you think that Zinn got herself into those problematic situations? Should the central Y leaders, such as Walker, have anticipated the problems and put the brakes on the initial proposals? Why or why not? What do you think about how Zinn handled getting out of those problematic situations?

Since Zinn is obviously a strong, successful leader, it is easy for students to talk about the mistakes that she made. In fact, these mistakes serve to make Zinn seem more human. Zinn is a high energy person who does not easily see boundaries or barriers. This quality usually serves Zinn well most of the time. Bostonians know that the North End, the Federal Courthouse and East Boston are within sight of one another, around and across the Boston Harbor. While the physical distance is short, the distinctiveness of the communities makes a common vision difficult. Zinn found that out the hard way.

The executives of the Greater Boston Y should monitor East Boston’s budget and other data with Zinn. If Zinn had the resources for the programs, she should have been allowed to decide whether or not to pursue the North End and Federal Courthouse programs. People often learn the most from the mistakes. If the East Boston Y were losing money and wasting resources, then it would be important for the Y executives to intervene to protect the organization’s bottom line.

### ***III. Deciding and recommending new space for the East Boston Branch***

- A. Who are the key stakeholders with whom Zinn should speak before she makes a recommendation?

(Teaching note: one way to do the stakeholder analysis is to break the class into small groups and have each group report out).

Possible stakeholders:

- Greater Boston Y central office executives
- MBTA officials
- Members of the East Boston community
- Board members of East Boston Y branch
- Existing East Boston branch members
- Employees of Greater Boston Y

B. What concerns or issues do you suspect each stakeholder would express? What success factors would they anticipate?

Identify concerns/issues and success factors each stakeholder may have for a new East Boston YMCA facility. Below is a sample stakeholder map.

<b>Stakeholders</b>	<b>Concerns/Issues</b>	<b>Success Factors</b>
Y Central office management	<ul style="list-style-type: none"> <li>- Funding to support development</li> <li>- Membership growth</li> <li>- Profitability</li> <li>- Potential to expand in future</li> <li>- Unaffordable</li> </ul>	<ul style="list-style-type: none"> <li>- Break-even</li> <li>- Strong growth</li> <li>- Community childcare support</li> </ul>
Massport officials	<ul style="list-style-type: none"> <li>- Lengthy development (construction) effort</li> <li>- Possibility that YMCA would require additional funding from Massport</li> </ul>	<ul style="list-style-type: none"> <li>- Utilize unused space</li> <li>- Secure long-term lease</li> <li>- Recognition in development of East Boston community</li> </ul>
Members of the East Boston community	<ul style="list-style-type: none"> <li>- Imposition on historical landmark</li> </ul>	<ul style="list-style-type: none"> <li>- Build community support and awareness</li> <li>- Bring other business to community</li> <li>- Support childcare needs</li> </ul>
Board members (of East Boston branch)	<ul style="list-style-type: none"> <li>- Funding</li> <li>- Unaffordable</li> <li>- Imposition on historical landmark</li> </ul>	<ul style="list-style-type: none"> <li>- Break-even</li> <li>- Strong growth</li> </ul>
Existing East Boston branch members	<ul style="list-style-type: none"> <li>- Higher fees</li> </ul>	<ul style="list-style-type: none"> <li>- Better childcare facilities</li> <li>- Health club amenities</li> <li>- Community programs</li> </ul>
Employees	<ul style="list-style-type: none"> <li>- Funding</li> <li>- Limited resources</li> </ul>	<ul style="list-style-type: none"> <li>- More space</li> <li>- Greater offering</li> </ul>

	- Potential to expand in future	
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C. What should Zinn recommend to the Greater Boston Y executives? “Go” or “no go?”  
Please vote.

Most students vote for the Y to submit a proposal to the MBTA for the Engine House. The general philosophy is a “bird in hand is worth two in the bush.”

### **Epilogue**

The central Y executives, based on the strong recommendation from Zinn, decide to renovate the Engine House. Design of the new facility is underway in December, 2003. Construction, however, has not yet begun because of parking issues.

Recently, Zinn successfully won a \$350,000 grant from a major Boston-based financial services company. This grant was one of the largest in the history of the YMCA of Greater Boston.

### **References:**

Duck, J. D. (2001). *The Change Monster: The Human Forces that Fuel or Foil Corporate Transformation & Change*. Crown Business Publishers: New York.

Hummel, J.M. (2002). *Starting and Running a Nonprofit Organization*. University of Minnesota Press: Minneapolis.

Kouzes, J.M. and B. Z. Posner (2002). *The Leadership Challenge: How to Keep Getting Extraordinary Things Done in Organizations*. Jossey-Bass Publishers: San Francisco.

[www.rightonthemoney.org](http://www.rightonthemoney.org): this is the website of financial advice-giving experts.

[www.franchise.org](http://www.franchise.org): this is the website of the International Franchise Association, the largest franchisee trade group in the USA.

[www.franchiseresearch.com](http://www.franchiseresearch.com): this is the website for people who wish to buy-and-sell in the franchise arena.



## **EMBRYO CASES**

## **An American University in Russia**

Geraldine A Kisiel, Central Michigan Univ - akrti@att.net

*Presented at the EMBRYO session of the Case Association 2004 Meeting*

Keywords: University, Management, Russia

### **ABSTRACT**

This is an AN AMERICAN UNIVERSITY IN RUSSIA embryonic case dealing with an American University in Russia. The research methodology was field interviews performed by a Professor hired to teach temporarily at the University.

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The full text of this Embryo Case is not included in the proceedings. Please contact the author to obtain a copy of this case.

## **Buscando por amigos en Mexico (Looking for friends in Mexico)**

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Pramila Rao, George Washington University - pramilarao@aol.com

*Presented at the EMBRYO session of the Case Association 2004 Meeting*

Keywords: Doing business in Mexico, Culture

### **ABSTRACT**

In Mexico, maintaining harmonious relationships with relevant personnel is critical in business relationships. This is undeniably linked to Mexican cultural values that emphasize on “getting to know” people and also their anxiety towards “unknown people.” Researchers attribute such values to collectivist thinking and also uncertainty-avoidance. Further, a historical context helps understand such cross-cultural issues better. Mexico was born after long years of war with its colonial ruler, Spain. Further for decades it has remained a subordinate to its powerful American neighbor. Therefore, it is not surprising that Mexicans have adopted a cautious attitude to foreigners.

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The full text of this Embryo Case is not included in the proceedings. Please contact the author to obtain a copy of this case.

## Collier College Needs to Decide

Frederick J. DeCasperis, Siena College - decasperis@siena.edu

*Presented at the EMBRYO session of the Case Association 2004 Meeting*

Keywords: -none-

### ABSTRACT

Collier College has to decide. The American Institute of Certified Public Accountants (AICPA) has mandated that all future members must complete 150 college credit hours in order to attain membership. The school's largest major is Accounting. What should they do? Five years later it is decision time again. The AICPA mandate is not yet law, but Collier has instituted an MBA degree, the school's only graduate program. The College now wishes to seek accreditation from the prestigious Association to Advance Collegiate Schools of Business (AACSB). This difficult task would be easier without a graduate program. What should they do?

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The full text of this Embryo Case is not included in the proceedings. Please contact the author to obtain a copy of this case.

## **Corporate Social Responsibility in the Brazilian Context: the Case of O Boticario**

Norman de Paula Arruda Filho, ISAE/FGV (Jardim Botânico, CEP, Curitiba, Paraná, Brazil) - Norman@fgvpr.br

Hsu Y. O`Keefe, Pace University - hokeefe@pace.edu

Linda M. Sama, Pace University - lsama@pace.edu

Cintia Carla Takada, ISAE/FGV (Curitiba, Paraná) - cintia@fgvpr.br

*Presented at the EMBRYO session of the Case Association 2004 Meeting*

Keywords: Corporate Social Responsibility, Sustainable Development, Emerging Economies

### **ABSTRACT**

The case subject company, O Boticario, is a Brazilian company in the cosmetics, perfume and personal care industry. Our research is focused on this company's efforts to articulate and pursue its corporate social responsibility agenda by contributing to local and national sustainable development initiatives. The case would be structured for use in courses on Strategic Management, Business and Society, International Business, and Business Ethics.

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The full text of this Embryo Case is not included in the proceedings. Please contact the author to obtain a copy of this case.

## **D & H Management, LLC**

Herbert Sherman, Southampton College - hsherman@southampton.liu.edu  
Daniel J. Rowley, University of Northern Colorado - djrphd1@msn.com

*Presented at the EMBRYO session of the Case Association 2004 Meeting*

Keywords: Ethics, Small Business Management, Entrepreneurship

### **ABSTRACT**

This four part disguised, field-based case introduces students to several typical business issues: whether to enter a new business, managing the business, and buying out one of the owners. The teaching note is partially completed at this time.

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The full text of this Embryo Case is not included in the proceedings. Please contact the author to obtain a copy of this case.

## **District of Columbia Public Schools**

Deborah Smith Cook, George Washington University - dsmithcook@msn.com  
Kimberly Freeman, The George Washington University - kefree@gwu.edu

*Presented at the EMBRYO session of the Case Association 2004 Meeting*

Keywords: leadership, governance, structure, stakeholder management

### **ABSTRACT**

This case is about the transition taking place in the DC Public schools. The Superintendent has just retired amidst controversy on how the school system should be run. Questions about leadership, structure, and stakeholder management will be addressed.

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The full text of this Embryo Case is not included in the proceedings. Please contact the author to obtain a copy of this case.

## **Ethical Erosion at Windswept Farms**

Carol C. Cirka, Ursinus College - ccirka@ursinus.edu

Carla M. Messikomer, The Acadia Institute - acadia institute@comcast.net

*Presented at the EMBRYO session of the Case Association 2004 Meeting*

Keywords: Business ethics, long term healthcare

### **ABSTRACT**

The Executive Director of a 130-bed assisted living facility owned by a for-profit corporation confronts the Resident Care Manager over a near-tragedy involving a resident. The case focuses on everyday ethical dilemmas in the assisted living industry. Analysis of this problem reveals tensions between delivery of care, financial pressures and expectations of families and residents. The case provides an opportunity to integrate theory and practice from the field of bioethics with management of ethics in business settings. The case is intended for use in graduate and undergraduate courses in management, business ethics or healthcare administration.

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The full text of this Embryo Case is not included in the proceedings. Please contact the author to obtain a copy of this case.



## **Jugos tropicales**

Steven F. Freeman, University of Pennsylvania - sf@alum.mit.edu

*Presented at the EMBRYO session of the Case Association 2004 Meeting*

Keywords: Entrepreneurial marketing, Entrepreneurial strategy, Developing World Entrepreneurship

### **ABSTRACT**

The importance of market segmentation and focusing on under-served markets

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The full text of this Embryo Case is not included in the proceedings. Please contact the author to obtain a copy of this case.

## **Just Tell Me The Rules! Or When Did The Rules Change?**

Valerie L. Christian, Sacred Heart University - christianv@sacredheart.edu

*Presented at the EMBRYO session of the Case Association 2004 Meeting*

Keywords: direct marketing, leadership, organizational goal-setting, loyalty, culture, business ethics,

### **ABSTRACT**

Anne is an experienced direct marketer. Just promoted to CEO, Anne proves to be naïve in managing The ABC Catalog Company, despite her twenty years of experience with the company. She prefers to set simple, straightforward rules for her direct reports to follow. Her management philosophy has been influenced by advice from her mentor and by her personal experiences working with her direct reports when they were her colleagues. According to Anne, “The big picture is for her (and perhaps her newly-appointed and trusted CFO, Jeff) to worry about.” Anne feels that many of her direct reports are incapable or unwilling to deal with the inevitable trade-offs that senior management must make, especially as new trends emerge. Yet she is unwilling to undergo a major management shake-up. Anne’s management approach backfires as the industry faces limits to growth and the company’s long-standing business model is tested. As management bonuses plummet and the parent company starts to meddle by bringing in consultants, the Merchandising SVP, Brad, sees his best career opportunity. He is frustrated with the diminished role Anne has allotted him and the perception that his nemesis, Jeff, is the heir apparent. That is supposed to be Brad’s destiny. His ego cannot take the slight. Brad takes the ultimate gamble, bringing his self-serving scenario of what ails The ABC Catalog Company to the parent company’s attention.

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The full text of this Embryo Case is not included in the proceedings. Please contact the author to obtain a copy of this case.

**Kija Kim, President and CEO, Harvard Design and Mapping, Cambridge,  
MA**

Lynda Moore, Simmons College - lynda.moore@simmons.edu  
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*Presented at the EMBRYO session of the Case Association 2004 Meeting*

Keywords: Kija Kim, Geospatial Information Systems, Leadership, Diversity, Minority and Women Business Owners

**ABSTRACT**

The focus of this case is on the successful leadership of Kija Kim, Founder, President and CEO of Harvard Design and Mapping, Inc. of Cambridge, Massachusetts. Founded in 1988, HDM has designed and developed advanced technology solutions specializing in Geospatial Information Systems for large governmental agencies. The case will highlight the leadership challenges and opportunities of the firm from its inception. It will focus on strategic, leadership, behavioral and diversity perspectives in order to capture the complexities of how an Asian woman in a male dominated and led industry has taken her company through critical growth stages.

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The full text of this Embryo Case is not included in the proceedings. Please contact the author to obtain a copy of this case.

## **Leading and Learning: Kristenn Einarsson and the Norwegian Book Club**

Jack McCarthy, University of New Hampshire - jack.mccarthy@unh.edu

*Presented at the EMBRYO session of the Case Association 2004 Meeting*

Keywords: Leadership, Strategic Change, Reflection, Identity & Adaptability

### **ABSTRACT**

The world is turning at The Norwegian Book Club, an organization facing dramatic industry-wide change. Although the 40-year old company continues to enjoy a dominant market position, as the largest and most successful distributor of literature in Norway, regulatory changes and increased competition threaten to topple its long-standing business model. The company's CEO, Kristenn Einarsson, is leading a radical organizational change process to attempt to prepare the company for an increasingly hostile future. The case study explores Mr. Einarsson's leadership development and decision-making as a way to study and further examine leadership and strategic change in a real-world context.

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The full text of this Embryo Case is not included in the proceedings. Please contact the author to obtain a copy of this case.

## **Leveraging Organizational Wisdom to Effectively Respond to Marine Oil Pollution**

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*Presented at the EMBRYO session of the Case Association 2004 Meeting*

Keywords: Oil Pollution, Environmental Response, Best Practices

### **ABSTRACT**

This embryo case explores the decision-making process used by Coast Guard Commanders when responding to maritime accidents involving significant oil pollution. Coast Guard Commanders are guided by U.S. law and federal regulations to ensuring a timely, effective response to significant cases of oil pollution. Yet, considerable latitude is given to those Commanders and they, therefore, rely upon institutional and organizational wisdom when it comes to making critical decisions. This case involves a tank barge carrying 180,000 barrels of heating fuel. The case looks at the decision making process involved when this barge ran aground in the environmentally sensitive Buzzard's Bay and began to discharge its cargo.

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The full text of this Embryo Case is not included in the proceedings. Please contact the author to obtain a copy of this case.

## **Mike's Apartment Crisis**

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*Presented at the EMBRYO session of the Case Association 2004 Meeting*

Keywords: Conflict management, Negotiation

### **ABSTRACT**

Mike Sato was told by Jill Stevens, the landlady of his apartment, that the housing authority found his apartment was illegally regulated and had to be shut down immediately. To solve this unexpected conflict, Mike decided to negotiate with the landlady cooperatively, and pursued monetary compensation, in exchange for a prompt evacuation. This case is for an introductory discussion of conflict management and negotiation that provides students an opportunity to think about basic concepts of negotiation such as goals of each party, and distributive and integrative bargaining. It is suitable for an undergraduate management or business communication course.

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The full text of this Embryo Case is not included in the proceedings. Please contact the author to obtain a copy of this case.

## **The Auto Insurance Industry And Auto Body Shops: Can The Shops Survive In The Era Of “Direct Repair?”**

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*Presented at the EMBRYO session of the Case Association 2004 Meeting*

Keywords: auto insurance, insurance industry, body shop industry, small business, proprietorships,

### **ABSTRACT**

Competition in the auto insurance industry is at an all-time high. Previous “high flyers” like State Farm Insurance, who has been the auto insurance industry leader for the past two decades, are finding themselves in almost hand-to-hand combat with quickly growing companies. With the advent of direct repair, auto insurance companies now exert tremendous control over auto body shops, who are being continually squeezed for costs. This case examines the changes in the auto insurance industry as they affect auto body shops, and closely examines two sole proprietorship body shops. The history of the two shops is covered, leading up to current challenges.

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The full text of this Embryo Case is not included in the proceedings. Please contact the author to obtain a copy of this case.

**The Greater Washington Educational Telecommunications Association, Inc.  
(Weta)**

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*Presented at the EMBRYO session of the Case Association 2004 Meeting*

Keywords: non profit, strategy, diversification, technology

**ABSTRACT**

WETA is faced with significant challenges as its television and radio markets are challenged with new competitors. Additional revenue streams must be developed to offset the decline in their core markets.

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The full text of this Embryo Case is not included in the proceedings. Please contact the author to obtain a copy of this case.



## **The Personal Health Diary**

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*Presented at the EMBRYO session of the Case Association 2004 Meeting*

Keywords: Entrepreneurship, Marketing Research

### **ABSTRACT**

This case provides the student with the opportunity to understand the entrepreneurial personality factors, as well as the blend of inspiration, perspiration, passion, persistence, and opportunity identification faced by many entrepreneurs. The case can be used in Entrepreneurship courses, as well as Marketing Research courses, as there are opportunities for the student to assess the appropriateness of Teri's choices as numerous decision points, as well as forecast options at the close of the case.

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The full text of this Embryo Case is not included in the proceedings. Please contact the author to obtain a copy of this case.

## **Wachovia Championship**

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*Presented at the EMBRYO session of the Case Association 2004 Meeting*

Keywords: golf management

### **ABSTRACT**

The purpose of this case is to provide for discussion the decision making process of tournament director Kym Hougham, as he prepared for the delivery of the first Wachovia Championship, a new event on the Professional Golfers Association (PGA) Tour schedule in 2003. At the time of Hougham's hiring, the event had a title sponsor, a golf course, and a lofty goal: to be one of the very best events on Tour, even in the first year. It was up to Hougham – at that point the only employee of the Wachovia Championship – to hire a staff, plan the event, design and implement a strategy that would make the goal a reality. He had less than one year to get it done. The case should have appeal in undergraduate management classes, as well as in sport management programs.

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The full text of this Embryo Case is not included in the proceedings. Please contact the author to obtain a copy of this case.

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## CALL FOR CASES (2005)

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**CASE** is interested in reviewing: a) cases in the advanced developmental stage, b) papers/symposia dealing with case writing and teaching, c) student authored cases, and d) "embryo" cases in the idea stage of development.

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**Student Authored Cases** This year we highlight student case writers and provide a special place on our program for them. **Student in need of guidance should, contact: Dr. Jack McCarthy – email: jack.mccarthy@unh.edu**

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