

Journal of Critical Incidents

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SCR Mission and Purpose

The Society for Case Research (SCR) facilitates the exchange of ideas leading to the improvement of case research, writing, and teaching; assists in the publication of written cases or case research and other scholarly work; and provides recognition for excellence in case research, writing and teaching. The society publishes three scholarly journals:

- Business Case Journal
- Annual Advances in Business Cases
- Journal of Critical Incidents

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October 26, 2009

WELCOME to Volume 2 of the *Journal of Critical Incidents*! This issue contains twenty-one critical incidents (CIs). The *Journal of Critical Incidents* is listed in Cabell's Directories. All of the Critical Incidents are original work based on primary research or developed from secondary sources. The incidents have not been previously published and are not under consideration for presentation or publication elsewhere. .

I believe that the CIs reflect a range of 'what it means to be a critical incident' and showcase scholarship across the broad topics of accounting, finance, human resource management, marketing, organizational behavior, and strategy. The richness of the CIs is reflected in their level of focus within these broad areas. In this issue, the CIs address: capital budgeting, fraud risk factors, auditing, bootstrapping, ethics and corporate social responsibility, international marketing and business, real estate, brand equity and image, target marketing, conflict resolution and negotiation, reputation management, product safety, new venture fiancé and capital, electronic communication, healthcare management, sustainability implementation, and small business.

Each published critical incident has a teaching note that is available through the Society for Case Research. The teaching note was double-blind peer reviewed and its scholarship quality was an integral part of the acceptance process. Teaching notes are available to adopters of the critical incidents for a fee and are available to the author(s) and their academic performance review committees without cost.

This volume is the product of a team. I appreciate the hard work of the authors who submitted and revised their CIs. Without them, there would be no journal! I owe a BIG thank you to the 38 SCR members who volunteered their time and talents to review the critical incidents and teaching notes. A special thank you goes to Sally Dresdow, the associate editor, for her work with the technology, being a sounding board throughout the process, and for her help with the final editing of the journal.

Joy Benson Editor
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CAMPUS BLOOD DRIVE SUSPENSION: EFFECTIVE OR INEFFECTIVE ORGANIZATIONAL DECISION MAKING?

Asbjorn Osland, San José State University
Noorein Inamdar, San José State University

SYNOPSIS:

This critical incident focuses on decision making. Though the Faculty Senate at CSU – North Bay voted on April 24, 2008 to suspend blood drives, the university president, Armando Ramirez wondered what to do. Should he ban blood drives based on alleged discrimination against gay men? A sister school within the California State University system, San José State University (SJSU), decided in early 2008 to suspend blood drives based on the opinion that the ban on donations from men who have had sex with men (MSM) was discriminatory. The descriptive material in the case focuses on SJSU's deliberations and decision making.

LEARNING OBJECTIVES:

The objectives of this case are for students to be able to:

1. identify the challenges in effective decision making
2. identify and employ techniques to improve decision making

APPLICATION:

The critical incident is best suited for decision making and leadership courses in public administration, higher education administration or health care administration, at both the undergraduate and graduate levels.

KEY WORDS:

Decision making, leadership, management

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CANCER WATER

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Steven M. Cox, Queens University of Charlotte
S. Catherine Anderson, Queens University of Charlotte

SYNOPSIS

Coca-Cola attempted to expand its market for Dasani water to Latin America. In Argentina it faced a coordinated Internet campaign to malign the purity and healthfulness of the product by the market leader Danone, bottler of Evian water. The campaign labeled Dasani a “cancer water” because of an issue a year earlier in England where Dasani had been found to contain higher than normal levels of bromate. Coca-Cola removed over 500,000 bottles of Dasani from retailer shelves, even though it was not proven that the levels of bromate were cancer-causing. During the launch of Dasani in Argentina, and subsequently other countries in Latin America, Danone placed a series of messages on the Internet branding Dasani “cancer water” and “bottled tap water.” Coca-Cola executives believed sales of Dasani suffered as a result of the campaign. The question in the case is what actions Coca-Cola should take now.

OBJECTIVES

The objectives of this critical incident are:

1. The student will be able to evaluate and discuss the possible effects of various communications plans on consumer attitudes.
2. The student will be aware of what constitutes deceptive and unfair practices and appreciate their legal and ethical implications.
3. The student will be able to identify and apply an industry code of ethics to determine the ethical nature of Danone’s actions.

APPLICATION

The Cancer Water critical incident is well suited for discussion in graduate or undergraduate courses in business ethics, especially on the ethics of Internet marketing, in consumer behavior, in business courses in new technology/media, or in international business.

KEY WORDS

Ethics, Internet Marketing, International Business

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DETECTING AND DOCUMENTING OCCUPATIONAL FRAUD IN A NOT-FOR-PROFIT COMMUNITY SERVICE AGENCY

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Carla Wiggins, University of Wisconsin-Milwaukee
Sarah Leeds, Family Services Alliance

SYNOPSIS

Lisa Sorrell, the executive director of Community Services of Idaho (CSI) decided that she must act on suspicions of fraud within the agency. Although Lisa had been on the agency's Board of Directors for two years, she had only accepted the job as executive director in June, just six months ago. After several months getting comfortable with her job, she suspected that the agency's office manager was somehow defrauding the organization. Several employees had commented that they had noted quite a bit of money flowing into the organization, but were always told by the office manager that money was very tight. Lisa had to develop a plan for how she would determine if fraud had occurred and, if so, document the amount.

LEARNING OBJECTIVES

The objectives of this critical incident are:

1. Define and describe occupational fraud and abuse.
2. Understand the purpose of internal controls and analyze the weaknesses in the internal control over cash in a medium-sized, community service, not-for-profit agency.
3. Analyze actual business documents to determine if fraud was committed and, if so, calculate the amount of such fraud for a one-month period of time.

APPLICATION

This critical incident is designed to be used in a basic financial accounting class, at either the undergraduate or at the graduate level. It may be covered after the students have read about internal controls and their importance to every organization.

KEY WORDS

Fraud, Internal Controls, Not-for-Profit

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HI-TIDE ON CAT CAY

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Margot B. Weinstein, MW Leadership Consultants LLC
Mark H. Bezik, Concordia University Wisconsin
Kenneth L. Stanley, Valdosta State University

SYNOPSIS

For the past several years, Tom had been trying to sell his island estate, Hi-Tide, on Cat Cay an island in the Bahamas. Tom listed the house with a real estate broker who had brought him an offer of \$2.8 million, which he accepted, two years ago. The deal fell through because the prospective buyer could not get the needed financing for the property. With several business deals beckoning for both his attention and capital, Tom needed to sell the estate...the sooner the better! Tom had been approached about the possibility of auctioning Hi-Tide. He was now considering his options which included listing the property for sale with a traditional realtor again or allowing an auction house to auction Hi-Tide.

OBJECTIVES

The objectives of this critical incident are to

1. Examine the role of a traditional realtor or broker in selling real estate, factors that influence home prices, and traditional methods of valuing a non-business property.
2. Evaluate the challenges of promoting a rather unique property.
3. Review and evaluate the common methods of valuing real estate.
4. Describe the auction process, including reasons to use auctions in situations when the traditional brokerage method may not be effective.
5. Discuss factors necessary in evaluating a decision to use an auction or a traditional brokerage approach to sell real estate.

APPLICATION

Hi-Tide provides an introduction to the fundamentals of auctions. Also included in the critical incident is the opportunity to introduce or reinforce real estate valuation methodologies. The critical incident can be used in an introductory real estate course at either the undergraduate or graduate level.

KEY WORDS

Real Estate

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LEADERSHIP TRANSITION AT 3M

Patrick Schultz, University of North Dakota
John Vitton, University of North Dakota
Duane Helleloid, University of North Dakota

SYNOPSIS

The critical incident describes the time in mid-2005 when 3M faced the challenge of replacing W. James McNerney, Jr., who left at the end of June to take the Chairman and CEO position at Boeing. McNerney came to 3M from General Electric in 2001 as the first outsider at the top position in the company, as well as the first leader without a technical background. McNerney centralized new product development and research efforts, and promoted a focus on innovation at the business-unit level in the company. To support these initiatives, he pushed for more rigorous evaluation of research and development efforts by managers and initiated the movement of resources from mature businesses to units with more growth potential. By the beginning of 2005, 3M reached \$20 billion in revenue but continued to be challenged by competitive markets and a plateau in its stock price appreciation. McNerney's departure at this time raises the issue of how to fill the CEO position of a large company with a tradition of innovation and creativity.

LEARNING OBJECTIVES

The objectives of this critical incident are:

- Understand issues of CEO succession and 3M's challenge in replacing McNerney.
- Determine the characteristics needed by the company and assess the immediate impact of McNerney's exit on the choice of his successor.
- Evaluate the different candidate options available to the company, principally the choice between inside and outside CEO candidates.

APPLICATION

This critical incident offers the opportunity to discuss leadership succession issues, and to develop ideas about the appropriate choice for McNerney's successor. The critical incident is ideally suited for courses in strategic management at the undergraduate or graduate level. In typical strategic management courses, the critical incident could be positioned in topic areas on top management decision making or corporate culture and leadership. A longer case study by the same authors, that describes the history of 3M and changes initiated under McNerney, was published in the Business Case Journal in early 2009.

KEY WORDS

Policy/Strategy, Leadership, CEO Succession

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NOT RETAIL THERAPY, BUT RETAIL MINISTRY: SOCIAL ENTREPRENEURSHIP IN COSTA RICA

Linda L. Brennan, Mercer University

SYNOPSIS

This case study presents the chronology of a venture started as a result of a mission trip to Costa Rica. While the participants involved view the undertaking as a ministry (that happens to make money), the scenario seems to have at least some of the hallmarks of successful social entrepreneurship. Given a foundation in the literature on social entrepreneurship, the reader has the opportunity to evaluate the venture and the value generated by it.

LEARNING OBJECTIVES

After reading this case, a student should be able to:

1. Define social entrepreneurship and distinguish it from conventional forms of entrepreneurship, non-profit work, and liberation theology.
2. Evaluate a venture to determine to what extent, if any, it is an example of social entrepreneurship.
3. Develop an analysis of the flow of benefits in the scenario.
4. Understand the potential challenges to a successful social venture.

APPLICATION

This case would be appropriate for a course in entrepreneurship, social entrepreneurship, or non-profit management, at either the undergraduate or graduate levels.

KEY WORDS

Social entrepreneurship, Value analysis, International

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OLIVE GARDEN AND THE PLAYBOY BUNNY

Karen A. Berger, Pace University
Colleen P. Kirk Pace University

SYNOPSIS:

Kendra Wilkinson loves Olive Garden, and she tells her boyfriend, her friends, and her 1.4 million fans. So what's the problem?

Kendra is the blonde bombshell star of *The Girls Next Door*, the popular E! television program about life as one of Hugh Hefner's girlfriends in the Playboy Mansion. Kendra loves Olive Garden, Darden Group's successful family-oriented Italian restaurant chain, so much she convinced Hugh to sponsor a "Sexiest Girls of Olive Garden" contest, with the prize of a nude Playboy pictorial. Normally, free publicity from a devoted celebrity customer would be welcome. However in this situation, the Olive Garden brand manager is not so sure.

This critical incident addresses the topic of brand equity in a context familiar to today's youth. The case assesses Olive Garden's extensive brand-building history, marketing strengths, and target market and provides an opportunity for students to discover the vital constructs of brand equity: brand loyalty, brand awareness, perceived quality, and brand associations, and evaluate them in relation to Olive Garden and Kendra Wilkinson's actions.

LEARNING OBJECTIVES:

The objectives of this case are:

1. To be able to compare and contrast target markets.
2. To identify and compare/contrast the brand image of the Olive Garden restaurant. with that of the 'Girl Next Door'.
3. To discuss the risk and rewards (benefits) of an association between Olive Garden and the 'Girl Next Door'.
4. To understand the elements of brand equity and be able to apply them to this case.
5. To examine the potential impact of unrequested publicity on marketing and branding efforts and to make recommendations for next steps.

APPLICATION:

This critical incident is appropriate for a principles of marketing, a consumer behavior or an advertising course.

KEY WORDS:

Brand Equity, Target Market, Brand Image, Publicity, Brand Loyalty

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P. DIDDY GOES THE DISTANCE**Christy L. De Vader, Loyola University Maryland****SYNOPSIS**

A university professor returned to her office after a five day vacation, signed onto the computer and started reading the work and non-work emails in her in-box. When she started reading her email she found that people she didn't even know had responded to a non-work email she had forwarded from work, before her vacation. At the time, she had thought the email was extremely funny. However, judging from the responses not everyone thought the email was funny, and to make matters worse, some people had even found it offensive. After reading the chain of responses she realized her email had been forwarded through several list-servers and literally thousands of people may have read her message and the responses it received. She realized that over five days some people may have read her message not once or twice, but up to ten times - with her name, position, title and organization included each time a reply was posted or the email was forwarded. As she looked at her in-box she wondered how she had gotten into this situation and what could she do about it now? And more importantly, what might be the consequences for her at work? Effective communication is the focus of the critical incident. The incident can be analyzed using several communication theories, models and concepts to identify what can be done to improve the effectiveness of the communication.

LEARNING OBJECTIVES

The objectives of this case are:

1. Use a theory or model related to effective communication to analyze this situation.
2. Evaluate the effectiveness of the communication in this situation using at least one communication theory or model.
3. Recommend what could have been done to improve the effectiveness of this communication using theories, models, or concepts about effective communication.
4. Understand guidelines professionals should follow when using electronic communication at work.

APPLICATION

The critical incident may be used in: Business Communications course to apply several communication theories, models, and concepts and to use them to explain the implications of media choice on the situation; Computer Applications for Business to understand the guidelines professionals should follow when using electronic communications at work; and in Organizational Behavior to apply theories of perceptual processes.

KEY WORDS

Electronic communications, communications theory, networks, perceptions

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PHOENIX MAGAZINE

Nancy E. Kucinski, Hardin-Simmons University

SYNOPSIS.

Ken Martin, founder, publisher, and editor-in-chief of Phoenix Magazine created a business model in which he offered a free publication with the primary purpose of providing the community a well written news, music and arts magazine. Phoenix Magazine primarily targeted the young, college age reader who wanted reviews and news of the local music and art scene. Ken made mistakes in editor and staff selection and found that he and his magazine had a bad reputation in the community. This issue, coupled with the fact that a large national advertiser pulled their ads from his magazine left Phoenix with a revenue crunch. Ken decided to shift his market focus from a college age reader, to an older adult and family readership. The decision point for Ken is how to attract mainstream readers in order to attract a new national advertiser. The immediate issue for students is to analyze what is needed to change the marketing mix that allows Ken to seek a broad readership; one that repairs his and his magazine's damaged reputations; and one that attracts a national advertiser. This critical incident is a decision critical incident.

OBJECTIVES.

The Objectives of this critical incident are:

1. Apply concepts of marketing mix theory using the 4Ps of product, price, placement, and promotion.
2. Evaluate the advantages and disadvantages of proposals for change.
3. Analyze the theoretical foundations of reputation management.

APPLICATION.

This critical incident can be used in an undergraduate marketing course or entrepreneurship course. Phoenix Magazine may be presented as an application of marketing mix theory using the 4 Ps of product, price, placement, and promotion (Perreault, Jr., Cannon, & McCarthy, 2008). Within a discussion of marketing mix, students will benefit from developing proposals for marketing changes and assessing the advantages and disadvantages of each proposal. Students will also be exposed to an introduction to issues of reputation management.

KEYWORDS.

Marketing Mix, Target Marketing, and Reputation Management

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POPULIST MAYOR APPOINTS *MINUTEMAN* TO KEY POST

Turner White, Rockhurst University, Kansas City, Missouri
Tom Lyon, Rockhurst University, Kansas City, Missouri

SYNOPSIS

The three, independent forces of immigration and social justice, racism and new, civic investment of \$3 billion converged on newly elected Kansas City Mayor Mark Funkhouser because of the ill-thought through political appointment of a 73-year old grandmother who was a member of the Minuteman Civil Defense Corps, a group of controversial, civilian and volunteer, immigration activists. The mayor's ineptitude politically and his lack of social acumen created a public crisis of leadership when he refused to change in the face of a contrary, city council vote and the threatened withdrawal of committed convention business for the city's new convention infrastructure. This case analyzes the crisis, the stakeholders and the consequences. It provides a method of anticipating such crises and offers a means for discussing alternative solutions to diffuse the crisis and restore credibility to the mayor's young tenure of only six months on a four-year term. This case allows students to discuss the sensitive issue of race and the public forum and the important role of unintended consequences in situations that are fully unanticipated by leaders.

APPLICATION

This case incident is best suited for classes in organizational communication, leadership, strategy and tax-exempt or governmental and political relations. Although graduate or MBA-level students will have more experience, we also recommend the incident for use in management and strategy classes for undergraduates.

LEARNING OBJECTIVES

After reading and studying this incident, students should be able to:

1. Identify and understand concepts and issues involved in leadership crises.
2. Identify major stakeholders and their positions.
3. Enumerate and discuss the direct and indirect damage evident in this case from poor decision processes.
4. Assess and judge leadership and communication styles.
5. Evaluate options available when faced with leadership crises.

KEY WORDS

mayor, diversity, populist, reputation, Minuteman

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PORNOGRAPHY AND THE UNIVERSITY COMPUTER

Leigh W. Cellucci, Ph.D., Idaho State University
Linda C. Hatzenbuehler, Ph.D. Idaho State University

SYNOPSIS

Mary Anne Baldwin, Director for the Center for Health Education at Western Idaho University, learned that Chloe Howell, a healthcare educator, allegedly had been using State of Idaho equipment to engage in pornographic activities. Even though the Center had an established procedure for hiring the best health educators available and training had been provided regarding professional behavior, evidence had been found to indicate that Howell had been engaged in pornographic activity using the laptop computer. It was a Friday afternoon and most university personnel would not be in their offices at that time. What should Baldwin do?

LEARNING OBJECTIVES

The objectives of this incident are:

1. Use an ethical decision-making process as a manager.
2. Review and follow HR stated policy regarding employee conduct.
3. Analyze employer and employee rights related to the employee's right to privacy versus an employer's right to monitor.
4. Illustrate and explain the significance of teams in HR investigations of employee behavior.

APPLICATION

This decision incident can be used in the following courses: Healthcare administration and generic undergraduate and graduate courses in management and human resource management that address and discuss the importance of managers' ethically addressing employee behavior.

KEY WORDS

Personnel, Organizational Behavior, Healthcare Management

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PROFIT OR PRODUCT SAFETY: AN ETHICAL SHOWDOWN

Stacy M. Vollmers, University of Wisconsin, River Falls
Clyde Vollmers, Russian American Institute

SYNOPSIS

Sally and Peter Johnson owned Quality Installations, a firm that makes and installs inclined elevators in primarily residential applications. Inclined elevators are outdoor trams designed to move people up and down hills. The most common applications are lake homes situated on sites with steep hills to the lake. While the view is valuable, the trek up and down the hill limits and often even prohibits enjoying the property.

During 2007 and 2008, their sales declined nearly 50%. While the economy and housing crisis are critical contributors to the problem, Sally and Peter believed that their commitment to the highest level of safety in the design and manufacturing of both their system and their installation also contributed to decreasing sales. They have always lost sales to lower priced systems that they believed were unsafe. But the current economic environment had put them into a weakened competitive position as customers became more price conscious. As a result, the percentage of lost sales had increased.

Sally and Peter examined competitors' products and installations and observed various issues that could potentially cause a product failure and fatally injure a passenger. They now must determine their strategy to address the safety versus price issue for Quality Installations.

LEARNING OBJECTIVES

The objectives of this case are:

1. To apply ethical decision-making frameworks to the facts of the case.
2. To use business and marketing theory to evaluate a business ethics decision and make recommendations regarding the best course of action.

APPLICATION

This critical incident (CI) is appropriate for business ethics and marketing principles courses. Further, the CI is appropriate for upper level undergraduate marketing or introductory MBA level marketing courses.

KEY WORDS

Ethical Frameworks, Product Safety, Small Business.

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REASONABLE ACCOMMODATION?**Jim C. Colling, Bechtel & Santo, LLP*****Roy A. Cook, Fort Lewis College****SYNOPSIS**

Steven Bradley, a job applicant with cerebral palsy, has filed a lawsuit claiming that Wal-Mart violated the ADA because it denied him employment based on his disability. Specifically, Bradley claims that Wal-Mart failed to make or consider reasonable accommodations that would have permitted him to perform the essential functions of the jobs he applied for. Wal-Mart maintains, based in part on their expert's testimony, that no reasonable accommodations existed and that it did not violate the ADA when it declined to hire Bradley. The EEOC contends that Wal-Mart must hire Bradley and make reasonable accommodation for his condition so that he can perform the essential functions of the positions in question.

OBJECTIVES

The objectives of this critical incident are to:

1. Describe the key provisions of the Americans with Disabilities Act as it pertains to employers, and apply those elements to the facts of this situation.
2. Understand the importance of identifying and documenting essential job functions as presented in job descriptions.
3. Understand the need to base employment decisions on defensible legal criteria.
4. Evaluate competing arguments and opinions to identify relevant information.
5. Identify and justify alternative courses of action that Janet could have taken to have avoided being in this position and what she might do if the court rules in favor of the EEOC and Bradley.

APPLICATION

The issue presented in this critical incident can be used in a variety of courses at both the undergraduate and graduate levels. Instructors may choose to use this critical incident in lower-level legal environment of business or introductory business law courses. It is especially well suited for upper level or graduate courses in human resource management and labor law.

KEY WORDS

Business Law, Human Resource Management, Organizational Behavior

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REFCO: OUTWITTING THE AUDITORS

Gabriele Lingenfelter, Christopher Newport University
Jennifer Barger Johnson, University of Central Oklahoma

SYNOPSIS

On October 10, 2005, Refco, Inc. announced that an entity controlled by its Chief Executive Officer, Phillip R. Bennett, and owed \$430 million to Refco. Refco immediately announced that investors and other third parties could no longer rely on its financial statements. The financial statements violated Generally Accepted Accounting Principles (GAAP). Grant Thornton, Refco's independent auditor, missed numerous fraud risk factors and gave an unqualified audit report on the financial statements included in Refco's Registration Statement and Prospectus.

The students are asked to identify the three conditions (fraud triangle) that are usually present when fraud occurs (AU 316.04). The students are also required to review SAS # 99 and the risk factors that relate to misstatements arising from fraudulent financial reporting (AU 316.85). The critical incident then asks the students to apply the fraud triangle to the Refco case and to identify the fraud risk factors occurring in the case.

LEARNING OBJECTIVES

The objectives of this case are:

1. Students will apply SAS # 99 and learn to identify the risk factors indicative of fraudulent financial reporting.
2. Students will use Auditing Standard AU # 316 to apply the fraud triangle to an actual company.

APPLICATION

The case is best suited for an undergraduate auditing class.

KEY WORDS

Auditing, fraud triangle, fraud risk factors, audit report

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SERUS: CONTINUE TO BOOTSTRAP OR SEEK VC FUNDING?

Anuradha Basu, San José State University
Minnie H. Patel, San José State University

SYNOPSIS

This critical incident (CI) is about the early evolution of Serus, a supply chain management software solutions company, which was started by two women entrepreneurs in Silicon Valley, California, who self-funded or bootstrapped their new venture. Unlike many technology entrepreneurs, these founders chose to focus on identifying a market and securing their first customers before seeking any external funding. They now have to decide how to fund the expansion of their company and whether or not to pitch for venture capital finance.

LEARNING OBJECTIVES

The objectives of this critical incident are:

1. Knowledge/comprehension – students should be able to explain the concepts of bootstrapping and venture capital, and the approaches entrepreneurs use to identify and validate new business opportunities.
2. Application/Analysis – students should be able to analyze the pros and cons of bootstrapping (self-funding) a new venture.
3. Synthesis/Evaluation – students should be able to evaluate the options regarding finance for expansion in terms of their consequences for the company and the founder-entrepreneurs.

APPLICATION

This CI can be used at the undergraduate or graduate level for courses in Entrepreneurship, Technology Entrepreneurship, New Venture Finance, or Small Business. It may be used to illustrate the choices available to entrepreneurs in financing their new ventures and how the appropriateness of alternative sources of finance may change, depending on circumstances and the evolutionary stage of a start-up.

KEY WORDS

Entrepreneurship, new venture finance, bootstrapping, venture capital

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SHOULD A PROFESSIONAL ASSOCIATION PROHIBIT ITS MEMBERS FROM HELPING THE GOVERNMENT: THE APA INTERROGATION DEBATE

Leigh W. Cellucci, Ph.D., Idaho State University

Tony Cellucci, Ph.D. Idaho State University

Mark Bezik, Concordia University

Eric Nelson, University of Central Missouri

SYNOPSIS

Sam Goldberg, Ph.D., psychologist and APA Council Member, must vote on whether or not psychologists may be present at detention facilities for foreign detainees. For over three years, Council members had been debating the appropriate role for psychologists in military settings. Some argued that psychologists should not be allowed to be consultants in detention facilities where controversial interrogations occur. Others argued that the presence of psychologists ensured that prisoners would not be abused. At the APA Council Meetings in 2007, the question was brought to a vote. Goldberg had to decide if he should vote for the moratorium and ban psychologists from being involved in detention facilities. Or, should he support psychologists' continued presence at detention facilities so that they might possibly make interrogations more effective, prevent abuse and help prisoners be kept safe?

LEARNING OBJECTIVES

The objectives of this incident are:

1. Identify clearly what the issues are in a viable ethical debate and apply applicable ethical theories.
2. Analyze the role of leadership within a professional organization: a) describe what constitutes leadership and b) be able to discuss the role of ethical values in leadership.
3. Describe effective decision-making and explain how broader political considerations and the media might influence organizational decision-making.
4. Evaluate the consequences of decision options critically, and defend a decision.

APPLICATION

This decision incident can be used in the following courses: Ethics; Organizational Behavior and Development, Business and Society; Organizational Leadership; Health Care Administration; Psychology

KEY WORDS

Ethics, leadership, corporate social responsibility

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**SONOMA WINE COMPANY:
ABSOLUTE OR INTENSITY TARGET FOR GHG EMISSIONS?****17**

Asbjorn Osland, San José State University**SYNOPSIS**

In doubling its capacity, the Sonoma Wine Company (SWC) successfully reduced its energy consumption and made more efficient use of water. In the process it adopted an absolute target for greenhouse gas (GHG) emissions, i.e., “Sonoma Wine Company pledges to reduce total U.S. GHG emissions by 15 percent from 2005 to 2010” (retrieved on April 15, 2009 from <http://www.epa.gov/stateply/partners/partners/sonomawinecompany.html>). As a member of the Environmental Protection Agency’s Climate Leaders program, it could have opted for an intensity target (i.e., reduced GHG emissions per unit of manufacturing target, in this situation measured in fewer GHG emissions/case of wine from time 1 to time 2), which would have allowed it to increase the overall GHG emissions due to growth (i.e., an absolute increase). The absolute target was difficult to achieve due to SWC’s capacity growth whereas the intensity target would have been readily achieved. Natasha Granoff, SWC’s Director of Business Development and in charge of sustainability at SWC, wondered if an absolute target was the appropriate decision? What were the risks associated with failure to meet the absolute target?

LEARNING OBJECTIVES

The objectives of this case are:

1. distinguish between intensity and absolute goals
2. understand the role of a superordinate goal in bringing different groups together
3. learn the varied and important roles of expert consultation and membership in trade associations in sustainability
4. contrast continuous improvement and discontinuous change and describe why both are necessary
5. use effective monitoring and measurement
6. develop effective stretch goals that are quantified and challenging
7. develop a sustainability program appropriate to a specific organization

APPLICATION

The critical incident can be used in Other (Management), Business & Society and Production/OM courses in relation to sustainability implementation.

KEY WORDS

Sustainability implementation

CONTACT

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**SPEEDING TOWARD TROUBLE:
JAY PEAK RESORT VERSUS THE TOWN OF NORTH TROY, VT.**

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Bonalyn J. Nelsen, Rochester Institute of Technology**SYNOPSIS**

This case incident focuses on the cause, escalation, resolution, and ethical implications of a conflict between a large northeastern ski resort and the municipal government of a nearby village. Trustees in North Troy, VT hired part-time constable Larry Zenobos to restore order in the unruly village. One of the constable's duties was to safeguard residents from Canadian motorists who sped through North Troy as they rushed to travel the final ten minutes to Jay Peak ski resort, the area's largest employer. Zenobos aggressively enforced North Troy's 25 mile-per-hour speed limit, issuing speeding tickets to unsuspecting Quebecers in what Jay Peak President Bill Stenger claimed were disproportionate numbers. Stenger claimed that Zenobos' enforcement practices actively discouraged Canadian skiers from patronizing the resort and placed his business at risk, leading him to repeatedly clash with Zenobos and North Troy's town board. As a new ski season approaches, Stenger must decide how to balance the needs of his business with those of North Troy's residents.

APPLICATION

The case incident is suitable for use in undergraduate and graduate courses in conflict resolution and negotiation, and in course modules on corporate social responsibility and in courses on strategic management, business ethics, business and society, and public administration or public policy. The critical incident is particularly well-suited for experiential learning techniques such as role play and student debate.

LEARNING OBJECTIVES

1. Identify and diagnose the causes of conflict by identifying and analyzing stakeholders' interests and objectives.
2. Identify and explain the causes and implications of conflict escalation.
3. Use the Thomas-Kilmann Conflict Mode Instrument to choose a negotiating strategy capable of resolving or minimizing conflicting stakeholder interests.
4. Create an action plan consisting of specific steps to minimize or resolve conflict between parties.
5. Assess the legality and ethicality of business decisions made in the context of a dispute with local officials and law enforcement.
6. Debate the ethicality of "speed traps" as a method of driving speed enforcement.

KEY WORDS

Conflict resolution, negotiation, corporate social responsibility, business policy and society.

CONTACT

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TO BID OR NOT TO BID?
IS IT TIME TO PURCHASE AN INVESTMENT HOME, MAYBE A FORECLOSURE?

Ann M. Hackert, Idaho State University
Jeff Brookman, Idaho State University

Synopsis

Jim needed to decide whether he should bid for a foreclosed property near a university. If he bid, the home would be used as a rental property. Jim has never bought a foreclosure and did not want to overbid. Jim had the cash available and his decision ultimately came down to getting the “right” price for a property. Determining the right price for the property involved assessing the appropriate cash flows, estimating a cost of capital and assessing the risks associated with his cash flow estimates.

Learning Objectives

The objectives of this critical incident are:

1. Identify multiple methods for valuing a property.
2. Estimate best case and worst case scenarios showing the dollar amount and timing of the cash inflows and outflows from purchasing and renting the property.
3. Evaluate the qualitative issues and risks that could affect the cash flows.

Application

This incident provides an opportunity for faculty to show multiple methods for valuing a property, including cash flow analysis and comparables. It also requires students to estimate best and worst case scenarios. Moreover, this incident highlights the uncertainties associated with cash flow estimates and estimating a cost of capital.

This critical incident is appropriate to use in introductory finance and upper-division undergraduate classes in investments and real estate. The case can also be used in spreadsheet modeling classes. If used in an introductory finance class, faculty may want to provide students with the information in Tables 1 through 3. In upper division classes, faculty can require students to read the incident and then develop the data as it appears in the tables.

Key Words

Finance, Capital Budgeting, Real Estate

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TRAINING SESSION CONFLICT

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Mark A. Johnson, Idaho State University
William E. Stratton, Idaho State University

SYNOPSIS

This incident deals with disruptive behavior in a training group during which one participant bluntly confronts another over his actions in the group. Others in the group then become embroiled on both sides in the ensuing discussion. The training group then tends to lose its focus and discussion of the incident continues in informal subgroups throughout the rest of the day and into the evening. The leader of the training program is left to consider what he might have done to intervene at the time of the incident, and now what, if anything, he should do upon reconvening with the group the next day. Issues of appropriate intervention during crises in group discussions and of revisiting group problems to maintain group focus and productivity are raised by this incident.

LEARNING OBJECTIVES

The objectives of this case are:

1. Students learn to recognize and anticipate potential sources of conflict in groups.
2. Students learn to recognize conflict management styles exhibited in a confrontational situation.
3. Students learn to analyze an interpersonal conflict situation and devise interventions to resolve conflict before it threatens to distract or derail the group from its intended mission.
4. In a situation where action has not been taken in a timely manner, students learn to design a late-intervention strategy or to actively decide to accept the consequences of doing nothing.

APPLICATION

The incident is appropriate for use in graduate or undergraduate courses in management, organization behavior, and group dynamics (after students have been exposed to basic concepts of group development and conflict resolution) and lends itself readily to role playing in addition to analysis of the situation.

KEY WORDS

Personnel/OB, Managing Group Conflict, Conflict Intervention

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WEIGHTED AVERAGE COST OF CAPITAL AT ROCKWELL COLLINS, INC.

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Ben Knutson, Ernst & Young
Craig Rabe, Luther College

SYNOPSIS

The Weighted Average Cost of Capital at Rockwell Collins, Inc. critical incident provides an opportunity for students to calculate the Weighted Average Cost of Capital (WACC) for a publicly traded firm using information available in the company's published financial statements. The setting for the case is a significant capital investment, the company's acquisition of a small European producer of electronic equipment for the military defense industry.

The capital structure of the firm is simple, resulting in a relatively straightforward WACC calculation. However, the case calls into question the suitability of the firm's WACC as a discount rate for the acquisition due to the differing risk profiles of Rockwell's two distinct business segments, the highly volatile commercial avionics (electronic equipment for commercial and private aircraft) industry and the relatively stable defense industry.

LEARNING OBJECTIVES

The objectives for the critical incident are:

1. Calculate the WACC for a publicly traded firm
2. Critically evaluate the suitability of a firm's WACC for a particular capital investment project
3. Understand the consequences of using an improper WACC to analyze a capital investment opportunity
4. Suggest methods to identify a more appropriate WACC for use in analyzing a particular capital investment project

APPLICATION

This critical incident is intended for undergraduate students enrolled in an introductory corporate finance course. The case is designed for use near the end of the term, requiring students to integrate their understanding of the very objective WACC and Capital Asset Pricing Model (CAPM) calculations with a more subjective analysis of the risk profile of a capital investment project in one of the company's two distinct business segments.

KEY WORDS

Capital, Cost, Investment, Finance, WACC

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CAMPUS BLOOD DRIVE SUSPENSION: EFFECTIVE OR INEFFECTIVE ORGANIZATIONAL DECISION MAKING?

Asbjorn Osland, San José State University
Noorein Inamdar, San José State University

This critical incident was prepared by the authors and is intended to be used as a basis for class discussion. The views represented here are those of the authors and do not necessarily reflect the views of the Society for Case Research. The authors' views are based on their professional judgment. The names of the president and of the organization have been disguised for CSU – North Bay but not for the remainder of the critical incident.

Dilemma at CSU – North Bay

Though the Faculty Senate at CSU – North Bay voted on April 24, 2008 to suspend blood drives, the university president, Armando Ramirez, wondered what to do. To decide contrary to the Senate could strain his relationship with some faculty but he believed he had to make his own decision. Other stakeholders were the students that organized periodic blood drives on campus with the local blood bank that counted on donations from young people, who tend to have fewer medical reasons to be excluded due to ill health than older people. Should President Ramirez follow the lead of a sister California State University campus, San José State University (SJSU), and suspend blood drives based on the opinion that the Food and Drug Administration's (FDA) ban on donations from men who have had sex with men (MSM) was discriminatory. SJSU defined discrimination in the broad sense of the word; one group (i.e., MSM in this instance) was excluded by the FDA because of its sexual orientation. However, there had been no legal opinions supported by the courts in the US that viewed rejection of high risk groups from donating blood as discriminatory.

On April 24, 2008 the CSU – North Bay Academic Senate approved, by a vote of 21 to 13, the following:

... Be It Resolved: that the Academic Senate ... strongly urges the campus Administration to rescind immediately the authorization of Blood Banks to operate on this campus, due to their discriminatory policy against gay men.

Rationale: ... University has a clear policy on non-discrimination, which includes discrimination on the basis of sexual/gender preference. Since the Reagan era of the early 1980's, by order of the Federal Food and Drug Administration blood banks are required to decline blood donations from male persons acknowledging during their pre-donation questioning having had sex with other men since 1977. This policy may have made sense when it was first implemented, because then the cause of AIDS was unknown and the disease seemed to target gay men preferentially. However, 24 years later, the cause of AIDS is known – the Human Immuno-deficiency Virus or HIV – and it can be, and routinely is, screened for in donated blood (along with many other pathogens). It is also known today that anyone can get AIDS, irrespective of sexual orientation. To maintain that gay men who donate blood are ipso facto a threat to the public health is simply an anachronistic and discriminatory stereotype. ...

President Ramirez read the resolution and considered the controversy. He wondered what to do?

Long-term Controversy in FDA

In 2000, the FDA (Josefson, 2000) voted 7-6 to continue with the lifetime ban against permitting MSM to donate blood. The stringent policy was adopted in 1985 because some of the blood supply had been contaminated with HIV. Table 1 contains a summary of the FDA's view:

Table 1
Blood Donations from Men Who Have Sex with Other Men

... MSM are, as a group, at increased risk for HIV, hepatitis B and certain other infections that can be transmitted by transfusion. ...

Men who have had sex with men ... have an HIV prevalence ... 60 times higher than the general population, 800 times higher than first time blood donors and 8000 times higher than repeat blood donors (American Red Cross). Even taking into account that 75% of HIV infected men who have sex with men already know they are HIV positive and would be unlikely to donate blood, the HIV prevalence in potential donors with history of male sex with males is 200 times higher than first time blood donors and 2000 times higher than repeat blood donors.

Men who have had sex with men account for the largest single group of blood donors who are found HIV positive by blood donor testing. ...

Having had a low number of partners is known to decrease the risk of HIV infection. However, to date, no donor eligibility questions have been shown to reliably identify a subset of MSM (e.g., based on monogamy or safe sexual practices) who do not still have a substantially increased rate of HIV infection compared to the general population or currently accepted blood donors. ...

It is estimated that the HIV risk from a unit of blood has been reduced to about 1 per 2 million in the USA, almost exclusively from so called "window period" donations. The "window period" exists very early after infection, where even current HIV testing methods cannot detect all infections. During this time, a person is infected with HIV, but may not have made enough virus or developed enough antibodies to be detected by available tests. For this reason, a person could test negative, even when they are actually HIV positive and infectious. Therefore, blood donors are not only tested but are also asked questions about behaviors that increase their risk of HIV infection.

Source: Retrieved on June 10, 2009 from

<http://www.fda.gov/BiologicsBloodVaccines/BloodBloodProducts/QuestionsaboutBlood/ucm108186.htm>

The Center for Disease Control (CDC, 2007, 2008, 2009) published periodic reports on the incidence of HIV/AIDS and concluded that MSM constituted the largest estimated proportion of cases. Another group with high rates of infection was the African American population, which can be seen in the Center for Disease Control reports (see <http://www.cdc.gov/hiv/>). In a report published by the CDC (June 10, 2009) researchers reported the following (note: Y stands for young):

- More than half (54%) of all cases of HIV infection or AIDS among young people aged 13–24 during 2003–2006 were from male-to-male sexual contact. Thirty-four percent were from heterosexual contact.
- Seventy percent of all HIV/AIDS diagnoses among youth aged 13–19 in 2006 were among black youth, even though blacks represented only 17% of the population in that age group.
- Of all YMSM, young black men who have sex with men (MSM) bear the greatest burden. More than twice as many black MSM aged 13–24 were diagnosed with HIV infection or AIDS in 2006 as their white or Hispanic counterparts. ...
- Among YMSM aged 13–24, young black MSM had the most dramatic increase in diagnoses—from 938 cases in 2001 to 1,811 cases in 2006, an increase of 93% ...

In another CDC (2007) report,

MSM accounted for 71% of all HIV infections among male adults and adolescents in 2005 (based on data from 33 states with long-term, confidential name-based HIV reporting), even though only about 5% to 7% of male adults and adolescents in the United States identify themselves as MSM.

Controversy surrounds what the deferral period (see Table 2) is for potential blood donors in that one can have sex with someone with HIV or women can have sex with MSM and only be deferred for 12 months while MSM are banned for life.

Table 2

Blood donor deferrals based on blood donor questionnaire used in US

Twelve month deferrals for potential blood donors are specified for a host of conditions including the following: received a blood transfusion, tissue transplant or grafting; had contact with open wounds and blood of another person; suffered a needle-stick exposure to another's blood; the potential donor paid for sex or had sexual contact with an IV drug user of non-prescription drugs; had sexual contact with someone that received a clotting factor or had sex with someone with hepatitis; the potential donor received a tattoo or piercing (but there are some exceptions), had syphilis or gonorrhea, or had been incarcerated. There are also varied deferrals (12 months to three years) for visiting or residing in countries with malaria or Leishmaniasis (Iraq). Indefinite deferrals are imposed on:

- people who have spent time in assorted European nations where they may have been exposed to Creutzfeldt-Jakob (i.e., mad cow disease - vCJD) or received a transfusion in the UK. Other questions also deal with vCJD and result in indefinite deferrals.
- prostitutes, MSM, IV drug users and people that had sex with a partner who was born in or lived in Cameroon, Central African Republic, Chad, Congo, Equatorial Guinea, Gabon, Niger or Nigeria after 1977 "because they may have been exposed to rare strains of HIV that are not consistently detected by all current test methods."
- potential donors who were born in or have lived in the preceding African countries and potential donors who have received a blood transfusion or any other medical treatment in Africa that involved blood.
- people that have HIV, or have or had viral hepatitis after age 11, Chagas, and babesiosis.

Source: http://www.aabb.org/Documents/Donate_Blood/Donor_History_Questionnaire/udhqflow05.pdf

Like the US, countries with indefinite deferrals for MSM include the following: Canada, US, UK, France, Switzerland, Holland, Norway, Denmark, Sweden, Germany, Finland, Iceland, and Hong Kong (Leiss, Tyshenko, & Krewski, 2007). In 2005, the European Blood Alliance concluded that "sex between men has an associated high risk of acquiring infections which can be transmitted by blood (including HIV)" (NHS, 2009). The EU members states that were also members of the European Blood Alliance included: Austria, Belgium, Denmark, Estonia, Finland, France, Germany, Hungary, Ireland, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Portugal, Slovenia, Sweden, and United Kingdom. However, some countries deferred people that engaged in risky behaviors for varying periods (e.g., Italy, four months; Spain and Australia, 12 months; and New Zealand, five years for MSM). Thus there was inconsistent treatment of donor deferral policies from nation to nation but most advanced countries excluded MSM.

President Don Kassing Orders the Blood Drive Suspension

Around the time the issue was being deliberated at CSU – North Bay, described above, the issue was also discussed at SJSU. Seth Hodge, a gay employee of SJSU, believed that the university was discriminating against gay men by allowing blood drives onto campus that would not take their blood because of the FDA's life time ban on receiving blood donations from MSM. "It was clear-cut policy issue," says Seth, the SJSU residential life coordinator who filed the complaint that brought the issue to Kassing's attention. We're not discouraging people from giving blood; we're saying it can't happen on our property because of our non-discrimination policy" (Panorama, 2008). The president's office studied the matter thoroughly and concluded that Seth was right – the FDA policy discriminated against MSM.

It was a tough decision for President Kassing but one that won him the support of the Academic Senate (Academic Senate, September 12, 2008) and various community groups that honored him for his decision to protest the FDA's lifetime exclusion of MSM.

In contrast to the blood drive ban, the Senate voted in 1997 to continue with ROTC in spite of its anti-gay policy. To ban ROTC would have resulted in the loss of federal funds needed on the campus. Loss of blood donations suffered by the local blood bank and its recipients was acceptable to the Senate but federal funds were required by the university so ROTC had to be tolerated in spite of the military's anti-gay policy.

President Kassing and his advisors concluded that the FDA lifetime blood donor ban on gay men violated the university's non-discrimination policy. He noted that the AABB, America's Blood Centers and the American Red Cross all supported a relaxation in the ban; they suggested that gay men be deferred for 12 months. Kassing thought the gay men should be treated as individuals. The FDA lumped all gay men in the MSM category; some gay men were in monogamous relationships and posed less risk than other MSM but were still banned for life. Kassing hoped the blood drive suspension would encourage the FDA to revisit the lifetime ban.

Some students disagreed with the blood drive suspension (Wright, 2008) and organized a blood drive at the neighboring Grace Baptist Church, a site that hosts numerous social services. The American Red Cross representative said the volunteers did a great job for an off-campus site. Michele Hyndman, the Public Relations Director at the Stanford Blood Center, stated (email September 03, 2008):

Stanford Blood Center typically collected 300 donations each year at SJSU. The American Red Cross collected 500 each year. ... Currently, 20% of our blood collection comes from students in high school and college. Particularly with students, if donating is not convenient, most won't seek it out on their own. If we're on campus and it's convenient, they donate. It's not as simple as saying "We're not discouraging people from giving blood; we're saying it can't happen on our property" because that's exactly what the ban does - keep people from donating.

Blood Industry Expert Commentary

No credible blood industry expert suggested that MSM be free to give blood. Testing of blood for HIV was still imperfect. There is some debate about the length of the deferral period (one or five years, for example) but that means that MSM would have to abstain from sex with men during the deferral period. One wonders who would abstain from sex to donate blood.

Leiss, Tyshenko, and Krewski (2007, 2008) maintain that changes to the donor deferral policy must result in improved or equivalent levels of safety to what presently exists. The analysis must comprise both risk procedures and ethical considerations. In terms of risk, the authors concluded that MSM donors present far greater risks than what they perceived as the current profiles of other donors. Since there are always very low risks that the various detection tools would fail, the authors concluded that changing the MSM deferral policy to no deferral or to a 12-month

deferral would increase the risk of tainted blood being transmitted to recipients. Researchers could assess whether or not another deferral period would be better than what is now essentially a lifetime ban.

When asked for his view on the matter, William Leiss (O.C., Ph.D., FRSC, Scientist, McLaughlin Centre, University of Ottawa) stated (on August 25, 2008):

Those that regard the MSM exclusion from blood donation as being unfairly discriminatory are not being inherently unreasonable, because this is an issue on which reasonable persons can disagree. I agree with the philosopher Hegel, who defined tragedy as “the struggle of right against right”; the issue in question is a tragedy of this sort. If one accepts the view that risk estimation has a legitimate place in blood donor policy, and that evidence-based risk assessment is appropriate here, then it seems true to say that a certain period of MSM exclusion is justified on precautionary grounds. I hold the view that the current evidence base justifies a five-year exclusion (five years sexually abstinent), taking into account both known pathogens (especially HIV) and the possibility that as-yet-unknown pathogens may be relevant to this judgment. Thus a shorter period of exclusion would amount to a risk transfer between MSM and blood recipients, which I believe is unethical.

On the other hand, the same principles stipulate that one should not accept a period of deferral longer than that which evidence and a reasonable level of precaution can support. Thus I reject the lifetime deferral currently applied in the U.S., Canada, and the EU.

In this context, is the decision by college- and university-based organizations, to ban blood donor clinics from campuses, an appropriately ethical act? I think not, because, from a tactical perspective, what it appears to be doing is using blood recipients as hostages in this disagreement. And that is unethical.

I believe that such organizations should use other strategies to seek to build support for a change in MSM donor deferral policy, such as the setting up of information sessions about the issue, and encouraging other bodies to join them in fostering an informed debate about blood donor and risk management policies. This debate should and could include what alternative types of donor screening would allow one to believe, with a high degree of confidence that an alternative system would assure as high a degree of blood safety as that which obtains at present.

When asked Dr. Jay P. Brooks (MD, MBA, Professor of Pathology, University of Texas Health Sciences Center San Antonio, TX) stated (August 23, 2008) stated:

In short, I view blood donation as a gift. Gifts can either be accepted or refused. Otherwise it is not a gift. Blood collection centers act as surrogates for recipients in delineating deferral criteria. The FDA ultimately promulgates the final rules.

While several organizations - the American Red Cross, the American Association of Blood Banks, and America's Blood Centers - have urged the FDA to alter the current lifetime ban on men who have had sex with other men since 1977, none has urged dropping the ban altogether. These organizations have been somewhat vague on this point, but they support either a five year or one year deferral period. Given that not many people are going to be voluntarily celibate for one or five years in order to be able to donate blood, the changes urged by these organizations will have little impact in allowing more gay men to donate.

Randy Shilts's excellent book "And the Band Played On" depicts the FDA and blood collection centers as being slow in deferring gay donors in the early 1980's and the impact that this had on the high rate of transfusion associated AIDS during that period. The FDA and blood collection centers were reluctant to eliminate gay men as donors for the very reason that it would appear discriminatory. It is ironic that the same organizations are now being criticized for being slow to allow these donors back into the donor pool.

When it comes to donor deferrals, I certainly oppose unfair discrimination. However, our primary concern must lie with the safety of the blood supply. Our laboratory tests are imperfect.

In a 2004 article by Dr. Brooks, he stated, that "two studies have indicated that changing the rule would increase the risk of human immunodeficiency virus (HIV) transmission" (p. 280).

What Should President Ramirez Decide?

SJSU's Kassing was praised by the community and the Academic Senate at SJSU for his decision to ban blood drives. He believed the FDA policy discriminated against gay men. Clearly the experts in the blood industry were still concerned about the risk of contamination if the ban on MSM donations were relaxed. At a sister school, also part of the CSU system of 23 campuses, President Ramirez of CSU – North Bay wondered, "Is it discriminatory to reject gay men as donors by lumping them as MSM that the FDA perceives as a high risk group?"

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CANCER WATER

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This critical incident was prepared by the authors, and is intended to be used as a basis for class discussion. The views represented here are those of the critical incident author/authors and do not necessarily reflect the views of the Society for Case Research. Authors' views are based on their own professional judgment/judgments.

It may not be unusual for the world's largest and most powerful companies to become targets of negative rumors, but that doesn't mean the world's largest companies won't fight back. In June 2007, the largest beverage company on the planet, Coca-Cola Co. (Coke), believed it was the victim of a vicious Internet campaign to ensure the failure of its premier bottled water brand, Dasani, in Argentina (Cassia, 2007).

Coke launched Dasani into the Argentine market in 2005. For the next two years, Coca-Cola battled Internet rumors referring to Dasani as "bottled tap water" and, even worse, as "cancer water." Coke believed these rumors had resulted from a coordinated campaign by the leading marketer of bottled water in Argentina, Danone, and its advertising agency, Euro RSCG (Cassia, 2007). Coke believed the misleading rumors resulted in significantly reduced sales of Dasani in Argentina and in surrounding countries. Coke's dilemma was how to respond.

Bottled Water

Bottled water was nothing new. The ancient Romans sold spring and well water (Brown, 2008). In Maine and Maryland, mineral water, thought to have healing powers, was bottled as far back as the mid-1800s (Brown, 2008). The modern bottled water industry, however, began in Europe. Until the 1970s, tap water was still unsafe in vast parts of Europe, which gave spring water brands such as Evian and Perrier a foothold in the beverage industry (Brown, 2008). Even as the total market demand for carbonated soft drinks began declining, the global bottled water market had grown dramatically, reaching a value of \$61 billion in 2006 (King, 2008). The market was forecasted to have a value of \$86 billion by 2011, an increase of 41.8% (King, 2008).

Coca-Cola began marketing Dasani bottled water in the US in 1999 (Beverage Digest, 1999). While 80% of Coke's business worldwide was in carbonated drinks, by 2007, the company's soft drink sales in North America were declining, while sales of "still" beverages such as Dasani were increasing (Brown, 2008). Coca-Cola credited growing still-beverage sales as contributing to its turnaround from a worldwide \$1.1 billion loss in 2006 to a \$711 million profit in 2007 (Brown, 2008).

After achieving success in the US, Coca-Cola began globalizing the Dasani brand in April 2004, when it introduced Dasani into the UK (USA Today, 2005). One month later, however, excessive levels of bromate (which studies had linked to cancer) were found in the UK Dasani bottled water. Bromate was a byproduct of filtering another chemical, bromine, which was considered nonthreatening (Lawrence, 2004). An investigation traced the bromate specifically to water that had been purified in Sidcup, Kent, from tap water drawn from the Thames River (Lawrence, 2004). Bromate levels in Dasani were only found above legal allowances within British markets where Dasani's filtration process added calcium chloride to the water as required by local law (Saitto, 2007). Coca-Cola emphatically proclaimed there were no immediate public health concerns with drinking Dasani (Medical News Today, 2004).

Despite its efforts to change the perception of Dasani in the UK, however, Coke decided to exit the UK market. Dasani had not encountered problems with excessive bromate in any other markets. Dasani, however, had not since returned to any European markets.

Dasani also faced criticism because it was filtered tap water that was sold at a much higher price than simple unfiltered tap water. Coke had openly admitted Dasani was drawn from local tap water. The company proudly proclaimed it purified the water through a state-of-the art filtration system (reverse-osmosis) that was originally developed by NASA (CBS News, 2004). Such filtering, Coca-Cola contended, meant Dasani was no longer mere tap water. The company referred to it as filtered "pure" water with minerals (Adams, 2004).

Coke's public relations problem followed the Dasani brand into Latin America. Coca-Cola encountered Internet rumors that appeared immediately after it introduced Dasani into Argentina in October 2005 (more than a year and a half after pulling it from the European market), referring to the brand as "cancer water" and as "bottled tap water" (US Water News, 2007). These same Internet descriptions followed Dasani as Coke introduced the brand into other Latin American countries, including Mexico, Colombia, Costa Rica, Chile, Peru, and Ecuador (Associated Press, 2007).

Fueled by these reports, activists against Dasani began offering "tap water challenges," including a challenge outside of Coca-Cola's 2006 annual meetings (US Water News, 2007). They offered passersby a taste test between regular tap water and Dasani, intending to demonstrate no distinguishable difference between the two waters despite the extraordinary difference in price.

With total Latin American sales of Dasani at a disappointing 18.9 million cases a year (Saitto, 2007), Coke argued these rumors had affected public perceptions and seriously damaged its sales (Saitto, 2007). 32

The Argentine market may have been affected the most severely. The company's market researchers claimed approximately 30% of Argentine consumers they surveyed had heard the rumors and 60% of those actually believed them (Saitto, 2007). Furthermore, significant potential Argentine distributors began refusing to sell Dasani in response to the rumors (Associated Press, 2007). By mid-2007, Dasani's Argentine market share was a disappointing 6%, which was approximately half what the company had projected (Saitto, 2007).

Coke executives believed the rumors had resulted from a deliberate misinformation campaign perpetrated by Danone, the producer of market-leading Evian brand, and by its marketing agency, Euro RSCG. In 2007, Danone commanded a dominant 53.7% of the Argentine bottled water market (Saitto, 2007).

Concerned about its Dasani brand image, Coke ran advertisements in major Argentine newspapers lamenting how its competitors had used the Internet to mislead millions of consumers with "false accusations" (Cassia, 2007). [A copy of that advertisement appears in Figure 1 with its English translation in Table 2.] Coke executives, however, were not certain these advertisements would rectify the problem and were considering taking more aggressive action.

Danone

In 2007, Danone was one of the world's largest manufacturers of dairy products, bottled water, baby nutritional products, and medical nutritional products. It ranked no lower than third globally in each of these categories. In the US, products such as Dannon yogurt and Evian bottled water were well-known brands.

Danone's worldwide sales were over \$18 billion in 2007. Nearly one-third of those sales were generated from the sale of bottled water products (Group Danone Annual Report, 2007).

Danone's corporate literature emphasized its civic and ethical responsibilities in a global environment. In its 2007 Annual Report, it restated the words of its founder, Antoine Riboud: "Growth for its own sake is meaningless. Growth must have a purpose, and that purpose is the increased well being of people" (Group Danone Annual Report, 2007).

Euro RSCG

Euro RSCG was a global integrated marketing communications agency. Employing over 10,000 people in 75 countries in Europe, North America, Latin America, Asia-Pacific, and the Middle East, its clients included 80 of the top 100 global marketers, including over 90% of the 50 largest global advertisers. Its client list included Air France, Charles Schwab, IBM, Kraft Foods, and Volvo (EuroRSCG.com, 2008). Danone had employed Euro RSCG to develop marketing and advertising strategies for its products, including Evian Water, in Argentina.

To fight the Internet rumors, Coca-Cola's Argentine subsidiary, Coca-Cola de Argentina, considered filing a criminal complaint against corporate executives within Danone and Euro RSCG. The complaint would accuse these executives of orchestrating a malicious smear campaign against Dasani through the widely circulated Internet rumors (Coca-Cola News Release, 2007) and through anonymous e-mails (Saitto, 2007). Coke considered the language used to describe Dasani as demonstrating unfair and deceptive business practices (Coca-Cola News Release, 2007).

Under Argentine law, only individuals could be prosecuted, not the corporation itself. The penalty, if those charged were found guilty, was limited by Argentine law to only \$10,000 per guilty individual, a technical slap on the wrist. The case, however, would be among the first in which a major international corporation had filed charges against a competitor alleging web-based attacks (Birchall, 2007).

Coke had to decide how far to go in defending Dasani. Feeling it was the victim of unethical and illegal competitive behavior, the company had several alternatives: take legal action against Danone's and Euro RSCG's executives under Argentine law, go on the offensive in the press, run more advertisements, exit the country, or do nothing and allow the situation to run its course. Coke wondered what positive effect or additional damage these actions could have on the Dasani brand name in other markets. What steps should the company take?

Figure 1: Coke's Argentinean Ad

SOLICITADA

Coca-Cola de Argentina querrela penalmente por competencia desleal a Directivos de Aguas Danone de Argentina y de su agencia Euro RSCG Buenos Aires por una campaña de desprestigio contra la marca Dasani.

Como ha sido reproducido recientemente por los medios periodísticos, Coca-Cola de Argentina querelló penalmente a dos directivos de Aguas Danone de Argentina y uno de la agencia de publicidad Euro RSCG Buenos Aires por considerarlos responsables del delito de competencia desleal. La querrela se basa en claras evidencias, presentadas ante la Justicia, de que dichos individuos diseñaron y llevaron adelante una campaña masiva de desprestigio en Internet que contenía información falsa sobre el agua Dasani. Estas acciones maliciosas que incitaban a cuestionar la calidad de Dasani engañaron a los consumidores, afectaron negativamente la reputación e imagen de la marca y, fundamentalmente, el trabajo cotidiano de miles de personas del Sistema Coca-Cola en la Argentina.

La Compañía Coca-Cola cuenta con un Sistema Global de Calidad y mantiene un compromiso histórico con la seguridad y calidad de sus productos en todos los mercados donde opera. El consumo de Dasani es absolutamente seguro para la salud, cumple con todos los estándares de calidad y requisitos establecidos por las autoridades argentinas y la Organización Mundial de la Salud, y está certificado por laboratorios de renombre a nivel latinoamericano.

La prueba que se ha puesto en manos de la Justicia sobre la campaña de Internet diseñada para desacreditar la marca Dasani, desviar ilegítimamente su clientela y obstaculizar su entrada al mercado argentino, es demostrativa de la comisión del delito. Por ello, se ha tomado la decisión inusual para la Compañía de presentar una querrela penal.

Internet es un valioso medio de comunicación con una capacidad única de llegar a millones de personas simultáneamente. Lamentablemente, en este caso, se hizo abuso de esta herramienta para engañar a los consumidores difundiendo información falsa con el objetivo de desprestigiar a una de sus marcas.

Como integrante responsable de la sociedad argentina desde hace 65 años, Coca-Cola de Argentina tiene un férreo compromiso con prácticas competitivas sanas y transparentes que permitan a los consumidores decidir qué producto comprar a partir de información completa y veraz.

Coca-Cola de Argentina

www.coca-cola.com.ar
0-800-888-8888

Domingo 15 de julio de 2007. Página 8

Table 1: English Translation of Coke's Argentinean Ad**Legal Action**

Coca-Cola of Argentina's legal action against unfair competition by the directors of Danone of Argentina and their agency, Euro RSCG Buenos Aires, stems from a campaign to discredit the Dasani brand.

As has been reported recently by the media, Coca-Cola of Argentina made took legal action against two directors of Danone of Argentina and one against the advertising agency Euro RSCG of Buenos Aires because Coca-Cola considered them responsible for unfair competition. The accusation is based on clear evidence, which was presented in court that these individuals created and spread a massive negative campaign on the Internet that contained false information about Dasani. These malicious actions made people question the quality of Dasani, deceived the consumers, harmed the reputation and image of the brand, and, most importantly, negatively affected the daily work of thousands of people of the Coca-Cola System in Argentina.

The security and quality of Coca-Cola's products has been maintained historically in all markets. The consumption of Dasani is completely safe for your health, it fulfills all the standards of quality and the requirements established by the Argentinean authorities and the World Health Organization, and it is certified by renowned Latino American laboratories.

The evidence that was given to the court about the Internet campaign that was created to discredit the Dasani brand, and to divert wrongfully their clientele, and to hinder their entrance into the Argentinean market, proves the charges made. That is why the Company has taken the unusual decision of taking legal action.

The Internet is a viable mode of communication with a unique capacity to reach millions of people simultaneously. Unfortunately, in this case, there has been an abuse of this tool in order to mislead the consumers by spreading false information with the objective of discrediting one of Coca-Cola's brands.

As a responsible member of Argentinean society for 65 years, Coca-Cola of Argentina has a strict obligation to competitive, healthy, and transparent practices that will allow consumers to decide what product to buy based on complete and truthful information.

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DETECTING AND DOCUMENTING OCCUPATONAL FRAUD IN A NOT-FOR-PROFIT COMMUNITY SERVICE AGENCY

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This critical incident was prepared by the authors, and is intended to be used as a basis for class discussion. The views represented here are those of the critical incident authors and do not necessarily reflect the views of the Society for Case Research. Author's views are based on their own professional judgments.

Introduction

Lisa Sorrell, the executive director of Community Services of Idaho (CSI) decided that she must act on suspicions of fraud within the agency. Although Lisa had been on the agency's Board of Directors for two years, she had only accepted the job as executive director in June, just six months ago. After several months getting comfortable with her job, she suspected that the agency's office manager was somehow defrauding the organization. Several employees had commented that they had noted quite a bit of money flowing into the organization, but were always told by the office manager that money was very tight. Lisa had to develop a plan for how she would determine if fraud had occurred and, if so, document the amount.

CSI Programs and Services

The stated objectives of CSI were as follows: to promote safe and happy families; to work to end physical and emotional abuse; and to provide victim support. In 2001, a Batterer Treatment Program was added so that offenders would have a treatment option in the area. Also in 2001, CSI secured grant funding from the federal government to expand services outside of the city and into four additional rural counties. A brief description of CSI's programs follows.

Domestic Violence and Sexual Assault Advocacy –This program included crisis intervention via phone or onsite via law enforcement agencies, a 24/7 Crisis Hotline, Emergency Shelter/Safe House for victims of violence, Court Advocacy, Case Management, Legal Aid Referrals, Counseling, Support Groups and Community Education.

Family Support – This program included a “Parents as Teachers” project involving in-home parent mentoring, Parenting Classes, Anger Management Classes, Supervised Visitation and Safe Exchange.

Batterer Treatment - Begun a few years ago, this program offered State of Idaho approved Batterer Treatment Education & Counseling to those who sought to gain control over, and understanding of, his or her violent nature.

CSI's Budget for the Current Year

The agency's annual budget had grown from approximately \$250,000 four years ago to around \$1.1 million for the current year which was about to end in a few weeks. Approximately \$900,000 of the \$1.1 million came from the numerous grants that CSI received from federal, state and local agencies. The other \$200,000 was derived from fees for program services. Checks and cash were regularly received from a variety of sources, including the batterer's treatment program “tuition,” child care fees, and donations. The typical amount of cash collections varied from about \$100 per week to over \$800 per week. These moneys were collected by a variety of employees who were instructed to prepare a two-part cash receipt – one copy for the client/donor and one for internal use and documentation. The cash and checks were put into a locked box and then at the end of each day given to the office manager, Betty Jones, who kept it in her drawer until she prepared a deposit ticket and made the bank deposit. Betty kept the books for each grant and for the agency as a whole and maintained the accounts receivable subsidiary ledger. She kept the bank statements and prepared bank reconciliations. When Lisa later looked at the receivables records, it was noted that several clients had fairly large, unpaid Accounts Receivables balances.

Office Manager

Betty had been the office manager for many years and had served under both Jimmie Webber, the agency's previous executive director, and Lisa Sorrell, the new director. According to both Lisa and Consuela, the agency's secretary, Betty was a real bully. The office staff and even the agency's executive directors had been intimidated by Betty's aggressive and strong personality. Consuela said that she had heard Betty screaming at employees behind closed doors.

Both Lisa and Consuela expressed the opinion that Betty felt that she had been entitled to the executive director's job but had been passed over by the Board. Betty had actually applied for the position several years ago when the board had chosen Jimmie, and had again been passed over when Lisa was hired. Betty had worked for CSI for approximately ten years and knew the organization inside and out. She was very private about the work that she did for the agency. Betty was the type of employee who never missed work and rarely took vacations. Because no one was cross-trained in her duties, work piled up whenever Betty was gone. She even found ways to refuse to cross train Lisa for her duties. At first Lisa had allowed this to occur, but finally she insisted that Betty teach her every aspect of the job.

Just recently, Consuela shared with Lisa that she did not trust Betty. Consuela indicated that Betty would not return calls to agency vendors and would scream at them. Consuela also said that, despite Betty's complaints that she was poor, she had told Consuela that she had spent about \$5,000 on Christmas presents for the upcoming holiday. Even though Consuela had suspected that something was "fishy" for a long time, she had not disclosed her feelings to Lisa for several months. Finally, she told Lisa of her suspicions. When Betty took a one week vacation near the end of the year, Lisa thought that this was a good opportunity to look into her suspicions of fraud and abuse.

Occupational Fraud

Joseph Wells, the founder and chairman of the Association of Certified Fraud Examiners, has defined occupational fraud and abuse as "the use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources or assets." (Wells, 2008, p8) This involves a wide variety of misconduct in any organization, from the lowest-level employee to the highest ranks of management. It may involve only one person or several people acting together. It may involve the misappropriation of the organization's assets, or the manipulation of financial reports for personal gain. Wells identified four common elements of occupational fraud and abuse schemes as activities that:

- 1) are clandestine
- 2) violate the employee's fiduciary duties
- 3) are committed for the purpose of direct or indirect financial benefit to the employee
- 4) cost the organization in the way of assets, revenues or reserves. (Wells, 2008)

The Records

Figures 1A through 1F provide the "pink," office carbon copies of the two-part CSI deposit ticket that Betty completed for each bank deposit. These represent several typical deposits that were made over a period of about one month, with checks listed in the pre-lined columns on the left side of the ticket and cash receipts, noted by Betty, in the side margin to the right. Figures 2A through 2F provide the official Central Idaho Bank deposit receipts for these deposits.

Betty made bank deposits periodically and prepared a two-part deposit ticket for each. The "white" bank portion of the deposit ticket was placed inside a deposit bag along with the cash, coins and checks that were being deposited into CSI's Central Idaho Bank account. The "pink" portion of the deposit ticket (Table 1) was kept for CSI by Betty. On this pink copy, but not on the top white copy, she listed the names of each of the clients who had given cash or coin to one of CSI's employees. From this "pink" copy, Betty could later book the credit to Accounts Receivable. The bank would take the deposit bag (containing checks, cash and the white copy of the deposit ticket) from Betty and give her another "empty" bag for the next deposit. The new bag contained the bank's official deposit receipt (like those shown in Table 2) from the previous deposit, after the cash and checks had been verified by the bank. Hence, if Betty were making a deposit on September 20th, the official bank receipt for the previous deposit (say, September 18th) would be given to Betty by the bank. Thus, there was a time lag between when the cash and checks were actually deposited (along with the white portion of the deposit ticket) and when

the deposit receipt was given back to CSI. The bank's deposit receipt was then stapled to the pink copy of the deposit ticket by Betty.

Time for Action

Betty had left for a one-week vacation at the end of December. Alerted by Consuela, and trusting her own suspicions, Lisa decided to use this opportunity to look at the deposit records and decide if anything “fishy” had been going on. If something was amiss, how much money did it involve?

Deposit Ticket			Figure 1A	
Idaho Community Services				
Spudtown, ID, 83211				
Central Idaho Bank				
1234 N. Idaho Rd.				
SpudFalls, ID 89101				
<u>Date</u>	<u>Dollar</u>	<u>Cents</u>		
8/2/2009			Cash in Deposit	
Currency	371	00	Jacob	150.00
Coin		50	Kretz	20.00
<u>Checks (list)</u>			Women Grp	60.00
1 Lemma, #4123	45	00	LeFarge	40.00
2 Facker, #6801	150	00	Devan	6.50
3 Lindy, #1851	189	00	Men Grp	85.00
4 Bloxer, #9628	150	00	Petty Cash	10.00
5 FSA, #13948	237	66		371.50
6 School Dist. 2	1,325	31		
7 FAP, #7826	9,346	91		
Total				

Deposit Ticket			Figure 1B	
Idaho Community Services				
Spudtown, ID, 83211				
Central Idaho Bank				
1234 N. Idaho Rd.				
SpudFalls, ID 89101				
<u>Date</u>	<u>Dollar</u>	<u>Cents</u>		
8/10/2009			Cash in Deposit	
Currency	465	00	Nargo	60.00
Coin	1	00	Smith, J	120.00
<u>Checks (list)</u>			Ranberg	120.00
1 Duke #123	356	73	King	60.00
2 Raser, #119	599	62	Jackson	100.00
3 Okle, 1490	3,132	58	Petty Cash	6.00
4 Conklin, 306	80	00		466.00
5 Un. Way 7729	4,539	78		
6 Sucsesco 55445	2,818	50		
7				
Total				

Deposit Ticket			Figure 1C	
Idaho Community Services				
Spudtown, ID, 83211				
Central Idaho Bank				
1234 N. Idaho Rd.				
SpudFalls, ID 89101				
<u>Date</u>	<u>Dollar</u>	<u>Cents</u>		
8/11/2009			Cash in Deposit	
Currency	155	00	Bassa	50.00
Coin			Hasteu	30.00
<u>Checks (list)</u>			Mens gripO	75.00
1 Lunnar, #4221	30	00		155.00
2 Betris, #336	65	00		
3 Bladz, #93	129	68		
Bora City,				
4 200219	25,525	81		-
5				
6				
7				
Total				

Deposit Ticket			Figure 1D	
Idaho Community Services				
Spudtown, ID, 83211				
Central Idaho Bank				
1234 N. Idaho Rd.				
SpudFalls, ID 89101				
<u>Date</u>	<u>Dollar</u>	<u>Cents</u>		
8/31/2009			Cash in Deposit	
Currency	475	00	Krank	25.00
Coin			Men Grp	195.00
<u>Checks (list)</u>			Widdage	60.00
1 Redd, #3021	48	00	J. Momma	100.00
2 Chaffy, #312	45	00	Miguel	50.00
3 Lemmar, #88	150	00	Women Grp	45.00
4 Bimark, #2156	100	00		475.00
5 Alby, #35611	198	38		
6 FTD, #7955	9,346	91		
7 Servco, #12952	11	16		
Total				

Deposit Ticket			Figure 1E	
Idaho Community Services				
Spudtown, ID, 83211				
Central Idaho Bank				
1234 N. Idaho Rd.				
SpudFalls, ID 89101				
<u>Date</u>	<u>Dollar</u>	<u>Cents</u>		
9/1/2009			Cash in Deposit	
Currency	104	00	Nakouson	25.00
Coin			Men Grp	75.00
<u>Checks (list)</u>			Hashim	4.00
1 Forcer, #678	30	00		104.00
2 James, #301	30	00		
3 Kemmerer, #99	650	00		
4 Bitsko, #156	50	00		
5 Un. Way #7889	4,539	78		
6				
7				
Total				

Deposit Ticket			Figure 1F	
Idaho Community Services				
Spudtown, ID, 83211				
Central Idaho Bank				
1234 N. Idaho Rd.				
SpudFalls, ID 89101				
<u>Date</u>	<u>Dollar</u>	<u>Cents</u>		
9/3/2009			Cash in Deposit	
Currency	445	00	Kewry	100.00
Coin			Kronke	30.00
<u>Checks (list)</u>			Men Gfp	160.00
1 Reyes, # 769	40	00	Women Gfp	120.00
2 Janson, #311	30	00	Deevens	<u>35.00</u>
3 Coster # 1124	1056	50		445.00
4				
5				
6				
7				
Total				

Central Idaho Bank			Figure 2A	
<u>Checking</u>	<u>Savings</u>	<u>Loan</u>		
X			THIS IS YOUR RECEIPT	
123456788	99852	2-Aug	\$11,450.38	D
deposits may not be avaiable for immediate withdrawal				

Central Idaho Bank			Figure 2B	
<u>Checking</u>	<u>Savings</u>	<u>Loan</u>		
X			THIS IS YOUR RECEIPT	
123456788	99852	10-Aug	\$11,533.21	D
deposits may not be avaiable for immediate withdrawal				

Figure
2C

Central Idaho Bank

<u>Checking</u>	<u>Savings</u>	<u>Loan</u>		
X			THIS IS YOUR RECEIPT	
123456788	99852	11-Aug	\$25,750.49	D
deposits may not be available for immediate withdrawal				

Figure
2D

Central Idaho Bank

<u>Checking</u>	<u>Savings</u>	<u>Loan</u>		
X			THIS IS YOUR RECEIPT	
123456788	99852	31-Aug	\$10,274.45	D
deposits may not be available for immediate withdrawal				

Figure
2E

Central Idaho Bank

<u>Checking</u>	<u>Savings</u>	<u>Loan</u>		
X			THIS IS YOUR RECEIPT	
123456788	99852	1-Sep	\$5,403.78	D
deposits may not be available for immediate withdrawal				

Figure
2F

Central Idaho Bank

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deposits may not be available for immediate withdrawal				

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HI-TIDE ON CAT CAY

Steven L. Good, Sheldon Good & Company Auctions
Margot B. Weinstein, MW Leadership Consultants LLC
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This critical incident was prepared by the authors and is intended to be used as a basis for class discussion. The views represented here are those of the case authors and do not necessarily reflect the views of the Society for Case Research. Authors' views are based on their own professional judgments.

Tom was worried – he was being pressured to sign another extension with his realtor. He just learned the sale of his house had fallen through: the buyer was unable to arrange the necessary financing. Granted his house was not your typical suburban house; instead it was a multi-million dollar luxury property located on a private island in the Caribbean. He thought his house had sold two years ago when he accepted the buyer's offer. With several business deals beckoning for both his attention and capital, Tom needed to sell his house....the sooner the better! Tom's realtor was anxious to sign another contract and "get busy" selling "Hi-Tide," the name of Tom's estate. Also, other realtors were approaching Tom about a chance to list the property for him. As Tom considered his options to sell "Hi-Tide" located on Cat Cay, he knew within a couple of days he would have to decide if he wanted to continue listing his property with his current realtor, engage another realtor, or possibly even sell via auction.

A **cay**, pronounced "key," was a small, low island consisting mostly of coral or sand. The word "cay" was used almost exclusively in the Caribbean. A cay was similar in structure to the small islands composing the Florida Keys. Cat Cay was a private island, owned by the members of the Cat Cay Yacht Club. The cay was said to once be the stronghold of notorious pirates like Harry Morgan, the Pirate King and Blackbeard. Like many of the isles in the Bahamas, it played a significant role in the American War of Independence, serving as an important base for confederate blockade runners. More recently, it was known as a place for the rich and famous. Many pioneers of deep-sea fishing vacationed there, and much of its early popularity was attributed to the annual migration of blue-fin tuna in the surrounding ocean waters.

Tom's estate was one of 67 luxury properties on Cat Cay. In order to own a home on Cat Cay, a prospective buyer was required to first become a member of the Cat Cay Yacht Club. Potential owners had to be sponsored by a current member of the club, seconded by another member and, after the candidate was vetted, the Board of Directors voted whether to accept or reject the

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proposed member. Members were required to submit a non-refundable initiation fee of \$25,000 (which was part of an equity buy-in of approximately \$250,000), along with prepaid annual dues of \$12,900. The Board of Directors would consider prospective members during their regularly scheduled meetings which were held six to seven times each year.

Non-members were allowed to visit Cat Cay, but were restricted to the marina area, which included a dockside bar, a restaurant/lounge, a commissary, a boutique, and a medical clinic. The rest of the cay included a pool and several beaches, tennis courts and a golf course, and these were available for members and their registered guests only. The island could be accessed by boat or by air. Cay Air Charters provided air transportation to Cat Cay and the surrounding area since 1996. This air carrier offered both scheduled flights and private charters to the cay. All flights departed from Fort Lauderdale. In addition, private planes could land on the cay.

Hi-Tide

Tom's home, Hi-Tide, was advertised as "one of the largest estates on this tropical jewel of an island." The property commanded breathtaking waterfront views of pristine beachfront. The property was further advertised as "a spacious, recently renovated five-bedroom villa, a separate two bedroom, two bath bungalow, and a caretaker's cottage, all on three divisible, and potentially very lucrative oceanfront lots." Finally, the main home was described as "designed for fun, with a large kitchen and adjoining dining area, great room with large fireplace and wet bar and huge, open terraces. Also on the main level are two guest suites both with en suite baths.... the master bedroom suite comprises the entire second level and features a large private terrace, while the top level offers a third, incredibly bright guest suite with a private observation balcony."

Past Attempts to Sell the House

Working with his realtor, Hi-Tide was on the market for three years. The realtor provided the typical and traditional services of listing and promoting the property: the property was listed with a Multiple Listing Service (MLS), a limited amount of advertising was done, and Tom's realtor showed the property a few times and arranged for other realtors to show the property. Tom received and accepted an offer of \$2.9 million for his property approximately two years ago. At the time, Tom was comfortable with the proceedings: luxury properties like Hi-Tide typically took longer to sell than smaller residential homes. However, the deal fell through when the buyer was unsuccessful at obtaining the necessary financing for the property.

As Tom stared out to the beach and the aqua blue sea beyond, he pondered after almost three years having passed, how he would again establish a reasonable selling price for his home. He remembered that many factors influenced housing prices and had discussed many of these with his realtor several years ago: population growth and employment growth in the area, growth in household income in the area; and the cost of rent for similar properties in the area. In addition, interest rates and income tax policies also influenced housing prices. As Tom reflected on these items, he was not sure how any of them would actually influence this situation.

As far as setting a value on his home, Tom's realtor indicated that there were usually two primary approaches to determining a value for a non-income producing property. These two methods were: 1) sales comparisons and 2) a cost approach. Both these methods were used to value typical residential properties and set a viable price.

For a sales comparison ("comparables" or "comps") approach, the appraiser estimated the value of a property by comparing selling prices similar to, and near, the property being appraised. Starting with recent sales prices for properties in the surrounding area, the appraiser then adjusted these prices for dissimilarities between the properties sold and the client's property up for sale. Some of the dissimilarities might include: age of the property; design appeal; quality of construction; size of rooms; etc. In attempting to determine true fair market value, the appraiser tried to ensure that the "comparable properties" sales were made at arms length and were not made under duress, as might be the case in a foreclosure or a bankruptcy situation. In these situations, the buyer might not have paid the true fair market value for the property.

Another option was a cost approach. The appraiser established a value for the land on which the property sat, and then added an estimated cost to "reproduce" the home at current construction costs. This cost of reproduction might be reduced for appropriate depreciation due to wear and tear on the actual house and its contents. Similar to the "comps" approach described above, the value of the land might be determined by looking at recent sales made in the area, adjusted for size, shape, and topography differences. Then, a construction cost-per-square-foot might be applied to determine a fair value for a similar, newly constructed home.

Despite Tom's knowledge of factors influencing housing prices, and the two methods of estimating value, he was still unsure as to how these factors and methods could be applied to his property. Hi-Tide was a unique property that did not easily lend itself to a simple appraisal and valuation.

Tom's previous realtor tried advertising on the island itself, talked with visitors to the island, and advertised on his (the realtor's) web site. The realtor hoped that the realtor community would find someone to buy the property. However, except for the one offer, these strategies had not produced anything. At this point, Tom had serious doubts that "more of the same" was going to produce anything different.

An Alternative

Tom initially "blew off" Dave Latvaaho's calls about auctioning Hi-Tide. Dave Latvaaho was employed by Sheldon Good and Company Auctions. Tom knew little about auctions, but he was under the impression most auctions were conducted for properties in foreclosure. This was not the image he thought would sell his island estate. But, Tom now thought that maybe it was time to at least listen to what Dave was proposing.

When Tom returned Dave's call, he immediately assured Tom that he and Sheldon Good & Company had significant experience selling high-end luxury properties. Dave explained that

Sheldon Good & Company could manage the entire process by strategically marketing the property in the United States, Europe, the Middle East and even Japan. They could also pre-qualify potential buyers to speed up the closing. He assured Tom that he would not “lose” another two years because the auction established a specific date within the next six months to actually sell the property. Furthermore, Dave explained that if the property was marketed properly (and Sheldon Good & Company could certainly do that!) this created an excitement around the auction that actually enticed prospective bidders into the process.

Tom was still not convinced that this was the right way to go. “Dave, will they sell Hi-Tide on the courthouse steps? And, how can I be sure that someone does NOT get my house for \$1,000?”

Dave chuckled and proceeded to explain to Tom the various potential auction methods for this property: open outcry, sealed bid, and sealed bid convertibles. He continued to explain each of these methods.

Open outcry reflected a gathering of people who “cry out” a bid on an item. An auctioneer was on-site to control the bidding and sale process. An open outcry auction was the format that people most often associated with auctions. Under this approach, a public forum was convened and bidders were invited to bid for each property offered. Unlike its open outcry counterpart, sealed bid auctions required each bidder to submit bids in writing. Results of the bidding process might or might not be disclosed to the bidders.

Sealed bid convertible auctions were hybrids between the sealed bid and open outcry approaches. In this format, the auction was started in a sealed bid format but rather than end by the owner picking the most desirable bid, the owner reserved the right to conduct a runoff between the highest bidders when the bids came in so close to one another as to make it unfair to the bidders to accept any one of them. The runoff could be done via an open outcry format wherein the highest bid served as the minimum bid or it could be done through a “highest and best” procedure. This procedure invited bidders to voluntarily and unilaterally increase their bids to make sure that they were given every chance to prevail in the bidding.

Dave further explained that in all three of the auction types there were three types of offering methods:

1. “With Reserve” auctions where owners reserve the right to accept or reject the final bid;
2. “Minimum Bid” auctions where a published minimum bid was established that then committed the owner to sell the property if any bid equaled or exceeded the stated minimum bid, and
3. “Absolute” auctions where the owner committed to selling the property, regardless of the final bid price.

Tom thanked Dave and promised to get back with his decision to auction Hi-Tide. If he did not, he would relist it with a realtor within the next couple of days.

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LEADERSHIP TRANSITION AT 3M

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This critical incident was prepared by the authors and is intended to be used as a basis for class discussion. The views represented here are those of the case authors and do not necessarily reflect the views of the Society for Case Research. Authors' views are based on their own professional judgments.

On June 30, 2005, it was announced that W. James McNerney, Jr., would be leaving the 3M Company to take the positions of chairman, president, and chief executive officer at the aerospace giant Boeing. McNerney joined 3M in 2001 after a long career at General Electric. Although 3M observers long suspected that this departure might occur, the announcement had come as a surprise to the company. In response to the rumors circulating about his status at 3M, McNerney released a statement earlier in the year saying that he was not in consideration for the Boeing job; in May, *BusinessWeek* reported that he turned down the job down (Holmes & Brady, 2005, May 23). Despite this reassurance, McNerney would indeed be leaving the St. Paul-based company after four-and-a-half years at the top, raising important questions for the company: who should succeed him as CEO and how would his leaving impact the significant changes he had put in place during his tenure?

Unlike recent CEO departures from Boeing—Phil Condit and Harry Stonecipher both left the company for ethics-related reasons (Holmes, 2005, March 21)—McNerney would be leaving 3M on good terms. He was quoted in *BusinessWeek* as saying, “My sense of loyalty there made it very difficult for me to contemplate leaving” (Holmes, 2005, July 7). He had already turned down two past overtures from Boeing’s board of directors, but had a change of heart in June at the Paris Air Show; within two weeks, Lew Platt, Boeing’s current chairman, persuaded him to leave 3M. Robert Morrison was immediately named as interim 3M chairman and CEO, and praised McNerney for his work at the company. During his time at 3M, McNerney restructured the company’s business units, added focus and discipline to its research and development efforts, grew the company’s sales from \$16 billion to over \$20 billion a year, raised the stock price from the mid-\$50 to low-\$70, and maintained its tradition of continuous cash dividends.

Established in 1902 as Minnesota Mining and Manufacturing, the company had its successes and failures in developing new products over the years. Many of its products were well known household names, including Scotch tape, Post-It Notes, and Scotchguard. The basic technologies of using thin films and adhesives to create a variety of useful products allowed 3M to develop products for personal use, industrial use, office supplies, and medical products, in a variety of industries worldwide. 3M had a culture of innovation, encouraging employees to work on interesting projects that might prove to have commercial applications. Over the years the company made acquisitions to help it expand in new areas, and sold off businesses that did not fit with its evolving strategy. Overall, however, most growth had come from expanding the use of its technology into new business segments. Up until McNerney had been hired, senior management had come up through the ranks in 3M, and typically had engineering and/or scientific backgrounds.

In hiring McNerney in 2001, 3M's board signaled a change in direction of the company. McNerney's experience at General Electric, known for its clear systematic and financial management approaches, could be used to help improve the focus and efficiency at 3M. McNerney moved quickly to implement Six Sigma practices, and focus 3M's efforts on those businesses and products that were believed to have the greatest growth potential. 3M also stepped up the pace of acquisitions, and tried to direct research at ideas that had clear potential for market success. Many within 3M applauded McNerney's more disciplined approach to management and research, and financial results showed improvement in most businesses. Other employees, however, lamented the loss of freedom to explore interesting ideas and products, and the shifting of resources out of historic 3M businesses with weaker financial performance.

Throughout 2004, growth in the company's stock price reached a plateau, and stubbornly resisted breaking through the highs reached in mid year. Despite continued growth, concerns expressed by McNerney late in the year about the state of worldwide demand for 3M's products weighed on the stock. Earnings per share in the third quarter of 2004 just missed expectations. While the company relied on a mix of revenue streams from a variety of businesses, and from a variety of geographic regions, over half of its sales came from foreign markets. It increasingly relied on the Asia-Pacific region, and specifically China, for growth opportunities, but also remained strongly tied to the U.S. for nearly 40% of sales. As a global company, 3M was increasingly vulnerable to demand fluctuations around the world, but also susceptible to risks stemming from its dependence on its home market. Tables 1 to 3 provide information describing the company's financial performance.

Figure 1
3M Stock Price Adjusted for Dividends and Splits.



Source: Yahoo! Finance

Table 1
Financial Summary, 3M Company (Dollars in millions, except per share amounts)

	2004	2003	2002	2001	2000	1999	1998	1997	1996	1995	1994
Operating Results											
Net sales	\$20,011	\$18,232	\$16,332	\$16,054	\$16,699	\$15,723	\$15,094	\$15,133	\$14,295	\$13,516	\$12,199
Operating income	4578	3713	3046	2273	3058	2956	2039	2675	2491	2221	2095
Income from continuing operations	2990	2403	1974	1430	1857	1763	1213	2121	1516	1306	1207
Per share – basic	3.83	3.07	2.53	1.81	2.35	2.19	1.50	2.57	1.81	1.56	1.43
Per share – diluted	3.75	3.02	2.50	1.79	2.32	2.17	1.49	2.53	1.80	1.55	1.42
Net income	2990	2403	1974	1430	1782	1763	1175	2121	1526	976	1322
Per share – basic	3.83	3.07	2.53	1.81	2.25	2.19	1.46	2.57	1.82	1.16	1.56
Per share – diluted	3.75	3.02	2.50	1.79	2.23	2.17	1.44	2.53	1.81	1.16	1.55
Financial Ratios											
Percent of sales											
Cost of sales	49.8	50.9	52.0	54.5	52.6	51.7	53.2	52.0	52.0	52.6	51.2
Selling, general and administrative expenses	21.6	22.2	22.8	25.1	23.6	23.5	23.5	23.7	24	23.9	24.8
Research, development and related expenses	5.7	6	6.5	6.8	6.6	6.7	6.8	6.6	6.6	6.5	6.8
Other expense (income)	–	0.5	–	-0.6	-1.1	-0.7	3	–	–	0.6	–
Operating income	22.9	20.4	18.7	14.2	18.3	18.8	13.5	17.7	17.4	16.4	17.2
Income from continuing operations	14.9	13.2	12.1	8.9	11.1	11.2	8	14	10.6	9.7	9.9
Total debt to total capital (total capital = debt plus equity)	21	27	36	32	30	29	34	30	24	23	22
Additional Information											
Cash dividends paid	\$1,125	\$1,034	\$968	\$948	\$918	\$901	\$887	\$876	\$803	\$790	\$744
Per share	1.44	1.32	1.24	1.20	1.16	1.12	1.10	1.06	0.96	0.94	0.88
Stock price at year-end	82.07	85.03	61.65	59.11	60.25	48.94	35.56	41.03	41.5	33.19	26.69
Total assets	20,708	17,600	15,329	14,606	14,522	13,896	14,153	13,238	13,364	14,183	13,068
Long-term debt (excluding current portion)	727	1,735	2,140	1,520	971	1,480	1,614	1,015	851	1,203	1,031
Capital expenditures	937	677	763	980	1,115	1,050	1,453	1,406	1,109	1,088	972
Depreciation and amortization	999	964	954	1,089	1,025	900	866	870	883	859	872
Research, development and related expenses	1,143	1,102	1,070	1,084	1,101	1,056	1,028	1,002	947	883	828
Number of employees at year-end*	67,071	67,072	68,774	71,669	75,026	70,549	73,564	75,639	74,289	85,313	85,296
Average shares outstanding – basic (in millions)	780.5	782.8	780	788.6	791.4	803.9	806.5	825.4	836.4	839.6	845.9
Average shares outstanding – diluted (in millions)	796.5	795.3	791	799.9	799.8	812.9	816	837.4	844.3	844.9	850.6

Source: 3M Company annual reports, 2003 to 2004

Table 2
Financial Summary by Geographic Region, 3M Company

Geographic Region	2004 Sales (millions)	% of Total Sales	2004 Sales Growth	2003 Sales Growth	2002 Sales Growth	2001 Sales Growth
United States	\$7,878	39.4%	3.9%	2.1%	(1.3%)	4.0%
Europe and Middle East	\$5,070	25.3%	9.7%	14.6%	1.9%	4.0%
Asia Pacific	\$5,168	25.8%	19.2%	26.3%	12.8%	15.0%
Latin America, Africa, and Canada	\$1,844	9.2%	11.7%	18.6%	(6.8%)	7.0%
Unclassified	\$51	0.3%				

Source: 3M Company annual reports, 2002 to 2004

Table 3
Financial Summary by Business Segment, 3M Company

Business Segment Information	Year	Net Sales (Millions)	Sales Change	Operating Income (Millions)	Operating Income Change	Assets (Millions)	Depreciation & Amortization (Millions)	Capital Expenditures (Millions)
Health Care	2004	\$4,230	5.90%	\$1,123	9.30%	\$2,636	\$179	\$165
	2003	\$3,995	12.20%	\$1,027	14.10%	\$2,544	\$169	\$144
	2002	\$3,560	7.90%	\$900	19.50%	\$2,409	\$166	\$183
	2001	\$3,301	9.80%	\$753	12.90%	\$2,190	\$187	\$171
Industrial	2004	\$3,792	13.10%	\$661	44.50%	\$2,771	\$214	\$167
	2003	\$3,354	6.60%	\$458	-6.10%	\$2,655	\$212	\$161
	2002	\$3,147	-0.50%	\$487	6.60%	\$2,685	\$191	\$158
	2001	\$3,163	-10.90%	\$457	-28.70%	\$2,660	\$199	\$201
Display and Graphics	2004	\$3,406	15.00%	\$1,131	27.80%	\$2,647	\$178	\$261
	2003	\$2,962	33.00%	\$885	65.80%	\$2,570	\$159	\$126
	2002	\$2,228	11.50%	\$534	43.50%	\$2,476	\$135	\$84
	2001	\$1,997	1.60%	\$372	-21.50%	\$1,619	\$169	\$117
Consumer and Office	2004	\$2,861	9.70%	\$542	17.90%	\$1,468	\$104	\$106
	2003	\$2,607	6.70%	\$460	2.50%	\$1,378	\$108	\$86
	2002	\$2,444	-3.20%	\$448	9.30%	\$1,354	\$108	\$90
	2001	\$2,523	-8.40%	\$410	-6.20%	\$1,429	\$133	\$123
Safety, Security and Protection Services	2004	\$2,125	10.20%	\$491	12.30%	\$1,317	\$101	\$99
	2003	\$1,928	14.40%	\$437	29.10%	\$1,139	\$100	\$46
	2002	\$1,686	2.80%	\$338	11.90%	\$1,097	\$97	\$105
	2001	\$1,639	1.60%	\$302	14.00%	\$1,054	\$104	\$122
Electro and Communications	2004	\$1,876	3.20%	\$291	14.10%	\$1,481	\$130	\$82
	2003	\$1,818	-0.70%	\$255	0.80%	\$1,568	\$138	\$43
	2002	\$1,831	-13.10%	\$253	17.70%	\$1,633	\$135	\$77
	2001	\$2,107	-12.10%	\$215	-46.10%	\$1,768	\$136	\$148
Transportation	2004	\$1,683	9.40%	\$428	10.10%	\$887	\$63	\$56
	2003	\$1,538	10.80%	\$389	16.80%	\$872	\$68	\$64
	2002	\$1,388	6.30%	\$333	23.30%	\$846	\$66	\$58
	2001	\$1,306	-5.20%	\$270	-3.20%	\$828	\$63	\$70

Source: 3M Company annual reports, 2001 to 2004

One of McNerney's efforts at 3M was the establishment of a formal leadership development process at the company (Alldredge et al, 2003). Modeled on General Electric's Crotonville leadership program, essentially GE's own business school for the education and development of its managers, 3M's Leadership Development Institute (LDI) was intended to identify managers

with high potential to lead the company in the future. McNerney spent time there working directly with participants in the program. Even with the LDI in place before McNerney left for Boeing, succession still loomed as a problem for the company since it had operated for only a limited time and no clear replacement for him was evident.

Press reports discussed possible successors for the CEO position, identifying both internal and external candidates (see Appendix 1). 3M historically looked inside for candidates to fill top management positions; although McNerney came from a top position at GE, the company could return to its tradition of pursuing individuals with technical backgrounds and track records with the company. Alternatively, top managers that came after McNerney joined 3M could also be tapped for the chief executive position. Finally, 3M could consider an outsider for the top executive post; perhaps it would again look to top managers at General Electric, as it did in 2001 when McNerney was recruited, as the source of the company's future leadership.

Appendix 1: CEO Candidate Descriptions

Patrick D. Campbell, CFO and Senior VP, 3M Company

Patrick D. Campbell (age 52) joined 3M in 2002 as Chief Financial Officer and Senior Vice President. Campbell was a highly visible member of McNerney's new top management team, and was very familiar with the challenges and requirements of the CEO position. Prior to coming to 3M, he was Vice President of Finance at General Motors Europe. He had a long history at GM, serving for 25 years and the company where he worked extensively in financial and international operations predominately in Switzerland and Germany. Campbell received both bachelors and masters degrees in business and management (Adamy & Lublin, 2005, July 1; Arndt & Brady, 2004; Business Week Online, n.d.e).

Jay V. Ihlenfeld, Senior VP, Research and Development, 3M Company

As the chief R&D manager at the company, Jay V. Ihlenfeld (age 53) lead 3M's global research and development efforts, and was a long-time veteran at the company overseeing technical employees in a variety of areas. He started at 3M while working on his doctorate in chemical engineering in the 1970's and joined the company's product development labs in 1978 after graduating from the University of Wisconsin at Madison. He worked in a variety of divisions around the world, in both technical and management areas of responsibility. His most notable position was at Sumitomo 3M, the company's largest subsidiary, where he served as executive vice president over more than 3,000 employees and \$2 billion in sales. He believed that establishing development capabilities closer to local markets was critical to fueling growth in new global markets. Since 2002, Ihlenfeld oversaw the reorganization of 3M's research and development activities, focusing corporate R&D on new growth opportunities, strengthening business-level development efforts, and using Six Sigma techniques to optimize development processes (3M Company, 2004; Del Re, 2005; Studt, 2003; University of Wisconsin-Madison College of Engineering, 2004, November 29).

David N. Farr, CEO, Emerson Electric Co.

David N. Farr (age 49) was the Chairman and CEO of Emerson Electric, a \$15.6 billion global, diversified company based in St. Louis, MO. Like 3M, Emerson Electric is involved in a variety of businesses that serve industrial, commercial, and consumer markets. The company provides technology-based products and services in supply chain management, industrial automation, power systems, telecommunications, and electrical components and tools. The company sustained a high level of performance in recent years, with a return on stockholder's equity of 18.4% in 2004, and 17.9% in 2003. International sales were \$7.4 billion, with a particularly high growth rate of 20% in Asia versus 4% in Europe. Emerson Electric was active in acquisitions and divestments, adding the plant and power systems business of Marconi Corporation PLC in 2004 and a provider of network power products to the Chinese market in 2002 (Adamy & Lublin, 2005, July 1; Business Week Online, n.d.c; Emerson Electric Co., 2004a and 2004b).

Farr joined Emerson Electric in 1981 and served as CEO since 2000. He had experience in the growing international business operations at Emerson Electric. Prior to his move to the top executive position, Farr worked for four years in Hong Kong as the president of Emerson Electric Asia-Pacific. During his time at the company, Farr emphasized emerging markets and increased manufacturing and engineering jobs in areas with high opportunity such as China. Farr also promoted the use of a leadership development system that sought out high potential managers from deep within the company. While Farr had a technical background with an undergraduate degree in chemistry from Wake Forest University, he also had an educational background in business with an MBA from Vanderbilt University (Business Week Online, n.d.b; Farr, 2005; Flannery, 2004).

George W. Buckley, CEO, Brunswick Corporation

George Buckley (age 58) was the chairman and CEO of Brunswick Corporation, a \$5.2 billion company focusing on recreation products. Based in Lake Forest, IL, Brunswick was a global company manufacturing boats, marine engines, and boating instrumentation; fitness products; and bowling and billiards equipment. The company engaged in manufacturing products and branding and marketing activities targeted toward both commercial and consumer markets. Sales grew 27% in 2004 and 11% in 2003. International sales amounted to \$1.7 billion in 2004 and \$1.2 billion in 2003, spread among European, Asian, and Canadian markets. Between 2002 and 2004, Brunswick spent nearly \$500 million on nineteen acquisitions designed to extend the company's access to foreign markets, build its brand portfolio, and exploit competencies (Arndt, 2005; Brunswick Corporation, 2004; Business Week Online, n.d.a).

Buckley joined Brunswick in 1997 after serving as a divisional president and CTO for Emerson Electric Company. He had a strong technical background, having a PhD in engineering from the University of Southampton. As head of Brunswick's Mercury Marine division, he oversaw the development of a new type of engine design that provided greater power, higher efficiency, and quieter operation. He quickly moved to the chairman and CEO position by 2000. He engaged in a strategy of rationalizing the portfolio of businesses acquired under previous management as well as extending the reach of the company through new acquisitions (Business Week Online, n.d.a; Business Week Online, n.d.d; Flight, 2005).

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NOT RETAIL THERAPY, BUT RETAIL MINISTRY: SOCIAL ENTREPRENEURSHIP IN COSTA RICA

Linda L. Brennan, Mercer University

This critical incident was prepared by the author and is intended to be used as a basis for class discussion. The names of the individuals and the organizations with the exception of Goodwill Industries are pseudonyms. The views represented here are those of the case author and do not necessarily reflect the views of the Society for Case Research. Author's views are based on the author's professional judgment.

As the unlikely mission team gathered at the airport, everyone's spirits were high. The twelve people were headed to Costa Rica, not knowing really what to expect. According to the team's guide, they would be helping a church with a construction project and vacation Bible school (VBS). The church would provide them with meals and accommodations, i.e., air mattresses in Sunday school classrooms. They had collected some supplies for VBS, brought a few tools, and packed clothes they planned to leave behind. That was the extent of their preparation – but really, no one could have prepared for the chain of events that would start from this trip.

The twelve people on the mission trip to the church in Costa Rica ("Inglesia") were friends and acquaintances from a church in the United States ("Memorial"). The arrangements were made through a small nonprofit organization by a pastor ("Jimmy") who was dedicated to facilitating people's entrance into the "mission field." They were hosted by the Inglesia pastor ("Rico") and his extended family.

For most of the team members, this was their first mission trip. The ophthalmologist in the group had been on two medical mission trips in the Caribbean. One couple on the trip had been to Costa Rica before, on a vacation. Only one of the members had been schooled in Spanish; the other Spanish-speaker had picked up the language by working with immigrants at restaurants. The mission guide assured them, however, that he had hired an interpreter, made all the arrangements for the trip, and that part of the experience was to get everyone out of their "comfort zone" as a matter of faith.

When the group arrived at the church in Costa Rica late that evening, it was a daunting sight. The church was enclosed in iron bars with a locked gate. Two cars were parked in the courtyard

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of the cement block buildings. As they waited to meet their hosts, the group sat in front of what seemed to be the house, on a set of mismatched chairs, and wondered whether they had made a mistake in coming on the trip.

As it turned out, the group had a unique combination of experience and expertise that fueled the idea of Inglesia's "retail ministry," a venture that would enable the church to raise money, perform community outreach, and provide employment opportunities. It was a simple idea that resonated far beyond their expectations.

It started when "Michael," the executive from Goodwill Industries, asked if he could be taken to visit the Goodwill affiliate in Costa Rica's capital, San Jose. He had been involved with Goodwill's international expansion in a previous position, and was curious to see what had happened to the San Jose organization. Michael, Rico, and Jimmy drove into the city one afternoon. They talked about Goodwill, and how it started, and what its purpose is, as a nonprofit organization.

Michael told them that it had started during the Great Depression, as a ministry by Dr. Edgar Helms. He would gather cast-off clothing from the rich people in Boston, Massachusetts, in response to pleas for food and clothing. His heart was particularly touched by the poor, needy foreigners who tended to have the hardest time finding employment. At the same time he was concerned about "pauperizing them... and taking from them their self-respect" (Plumb, 1968, p. 123). He settled on hiring many of the unemployed, and paid them wages to collect the discards, sterilize them, rehabilitate them (e.g., restore, remake, repair), and then sell them inexpensively.

Currently, "Goodwill Industries International is a network of 185 independent, community-based agencies in 17 countries that provides employment training and career services to people with disabilities, welfare recipients, displaced workers, and other job seekers. To fund its programs, Goodwill collects donated clothing and household goods, which it sells at more than 2000 retail stores" (Walters, 2007, p. 51).

Jimmy reminisced about a rummage store that was supported by one of the churches he had pastored in the past. It helped raise money for the church. He mentioned that Rico and he had talked about doing something similar for the Inglesia, by bringing used clothing from the United States as Jimmy brought more mission teams to Costa Rica.

As the men conversed, with Jimmy translating, Michael explained that his Goodwill organization might be able to help the Inglesia. As he explained it, donations of used clothing were inspected and merchandised at the Goodwill stores. They were tagged with a colored price tag. The color indicated what week the goods had been received. After four weeks, if the goods were not sold, they were bundled and sold as salvage goods to dealers. Instead, Michael suggested, the salvage could come to Costa Rica. The church could give away some of the clothing to needy families, and sell the rest at a low price.

They halted their discussion when they arrived at the Goodwill location in downtown San Jose. It was a gated property, with a single cinder block building. Inside, they found nearly forty disabled adults, doing some simple assembly jobs, e.g., putting together kits. As they introduced themselves to the director, she explained that they were no longer an affiliate of the Goodwill International organization, as they could not afford the dues. At this point, the operation was really a cooperative of the caregivers for these disabled adults. What little money they were able to raise from contract labor barely covered the modest expenses. Jimmy offered that the team could come to visit for an afternoon and provide a version of VBS to the people there; the director accepted, gladly.

Driving back to the small town Inglesia, the men's vision of the retail ministry started to expand. For goods that did not sell in Costa Rica, perhaps the disabled adults at Goodwill could work on them to reclaim the notions (i.e., zippers, buttons, snaps, etc.). Perhaps, in consideration for Goodwill donating the salvage goods to the church, the church could pay the local affiliate's fee to rejoin the Goodwill International association.

Their excitement about the idea was contagious. When they explained the concept to the rest of the mission team over dinner, the details began to fill in. The church actually owned a building across town that was being restored, slowly, and might be able to house the store and the goods. They would need about \$10,000 to start with the initial shipment, and thought that it would become self-sustaining, i.e., they would raise enough money from each shipment to enable them to pay for a subsequent shipment.

When Michael expressed his concern about how large the shipment would be (a shipping container would contain 20 tons), Rico thought they could spread the wealth by involving other churches, who might pay 50 USD for what they could sell for 100 USD.

Michael committed to following up on the details in the United States, to ensure the plan was feasible. He had an idea of the costs from his earlier experiences, but wanted to double check the details.

As the week progressed, the real estate developer became so enthusiastic about the idea; he committed to donate the start-up cash. The professional organizer, the college professor, and the construction and design general contractor also became involved. It was a "perfect storm" of abilities and interests:

Michael Goodwill Executive	Provided the Goodwill Industries connection; served as the salvage goods supplier
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Jimmy Mission Guide	Raised the initial idea; acted as the facilitator between Goodwill in the United States and Inglesia in Costa Rica
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Rico Inglesia's	Sponsored the ministry; supplied the location; managed the operations in Costa Rica
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Pastor

Real Estate Developer Donated the seed money

Professional Organizer Suggested ways that the Goodwill workers could work on the unsold goods, further extending their value

Management Professor Sketched out the project plan; later facilitated the negotiation of roles and responsibilities

General Contractor Suggested ways to turn the empty building into useful retail space.

By any measure, the week in the mission field was a success. Better still, it had sowed the seeds for further good work. However, it would be important to address some serious questions and potential issues, especially whether this initiative could be self-sustaining in the long term. Could it really deliver the benefits the team anticipated?

The following chronology describes the progression of events over the next year:

- August** Received funding commitment for initial shipment.
- September** Assigned Goodwill staff member, “Helen,” to assist in planning and communication.
- November** Drafted initial project plan.
- December** Obtained approval from Goodwill CEO to: have local Goodwill be the US sponsor of the Costa Rica Goodwill; to use the Goodwill letterhead to raise money from other Goodwill Affiliates; to act as a fiscal agent for the money; and to sell at least the first shipment of clothes at a deep discount (Michael, email communication, December 26).
- January** Developed pro forma analysis (see appendix A).
- January** Rico and his wife visited the team in the United States, toured the Goodwill, and discussed plans in detail. A statement of work, confirming everyone’s understanding was written (see appendix B).
- February** Solicited funds from other Goodwill affiliates
- May** Loaded, fumigated, and shipped the container from the Port of Savannah. The shipment contained “approximately 32,000 lbs. of clothing, 1000 plastic hangers, a bunch of rolling racks and boxes of

hats, purses, ties, belts and flips flops” (Michael, email communication, May 16).

May Experienced difficulty with Costa Rican Customs, as the bill of lading noted the hangers had “no value.” (Apparently, the customs agent told Rico, “Everything in Costa Rica has value.”)

May Jimmy flies to Costa Rica and helps Rico get the clothing out of customs; the hangers are held back.

In his ministry’s August newsletter, Jimmy reported that:

“Seven weeks ago [Rico] and his crew decided to open up the doors of the warehouse and start selling goods from a makeshift store front while they anxiously awaited the release of the racks and hangers from customs. In just seven weeks they have had many shoppers come through and have made enough money to pay the second month’s rent and all of the utility bills for the warehouse. Even better news is that they have already hired 7 people ... that were previously unemployed (sic)... Employees ... are opening the bales and sorting the clothing into plastic bags for Men, Women, Girl’s and Boy’s sizes. Before the merchandise is placed in the shopping area, 3 employees iron all of the clothing and fold it or put it on the few hangers they have been able to collect so far.”

APPENDIX A: Pro-Forma Analysis (Michael, email communication, January 28).

Assumption 1: Initial shipment to be in a 40 foot sea container with the following contents:

- the container holds approximately 40 bales
- the average weight per bale is 1000 lbs.
- the weight of goods shipped is therefore 40,000 lbs.
- on average, there are three garments per pound
- a load therefore contains 120,000 garments.

Assumption 2: 60% of the garments will be sold, as follows:

- Inglesia wholesales 50% of the load, 60,000 garments to other churches, who sell 60% of the garments (36,000 pieces). Inglesia receives .25 USD for each garment sold: $.25 * 36,000 = 9,000$ USD.
- Inglesia retails 50% of the load, 60,000 garments, and sell 60% of the garments (36,000 pieces), at an average retail of 1 USD: $1.00 * 36,000 = 36,000$ USD.
- Total sales receipts: $9,000 + 36,000 = 45,000$ USD.

Assumption 3: 40% of the Inglesia garments will be unsold; these items are stripped for buttons, zippers, and other notions, with the following proceeds:

- 24,000 pieces, with each piece generating 0.10 USD of residual value: $.10 * 24,000 = 2,400$ USD.

Total receipts:

36,000 USD retail
9,000 USD wholesale
2,400 USD residual value

47,400 USD gross receipts
(10,000) USD returned to venture capital fund

37,400 USD net proceeds for Inglesia

Postscript: Inglesia has agreed to donate 10% of profits realized to the Goodwill affiliate in Costa Rica. Future shipments from the Goodwill in the United States will be purchased at approximately 5,000 USD (“Jimmy,” private letter, March 8).

APPENDIX B: Statement of Work (Helen & Author, February 1).

Scope

The purpose of this project is to establish a retail operation, with plans for employment and future job-training programs, to the community in [REDACTED], Costa Rica with the help of [REDACTED] [“Jimmy’s”] ministry, [REDACTED] Memorial [REDACTED] Church, Goodwill Industries of [REDACTED], Ingelsia Methodista, the Goodwill “affiliate” in Costa Rica, and varied funding sources. By June 30, 2007 the initial delivery of goods will have been made to [REDACTED]; a volunteer team will have visited Costa Rica to assist in the set up the operation; roles and responsibilities will have been defined for continued operations; the initial staff of the operation will have been trained; and a plan for next steps will have been developed and agreed to by all stakeholders.

Objectives

The primary objective is to establish a profitable retail operation under the direction of Inglesia [REDACTED] to financially support the church’s ministries and its outreach efforts in the surrounding community. In turn, this will also provide a level of financial stability to the Goodwill affiliate of Costa Rica. Other objectives include:

- Extending the retail ministry to other churches in Costa Rica,
- Providing opportunities for Costa Rican individuals with barriers to employment to gain meaningful employment that will help them become financially self-sufficient,
- Creating additional activities for individuals, with barriers to employment, who are in daycare activities currently,
- Improving the economic status of the employees/trainees,
- Improving the skill level of the employees/trainees,
- Providing an opportunity for reasonable priced quality merchandise for Costa Ricans,
- Increasing the flow of capital in the Costa Rican economy,
- Developing new business lines in the Costa Rican economy,
- Establishing a framework for multinational distribution of donations through Goodwill,
- Providing an ongoing need for mission support from willing volunteers -- both from the Goodwill community as well as church congregations.

Stakeholders

The executive sponsor of this project is Goodwill Industries of [REDACTED]. The project manager is “Michael.” Advisors to the project are “Helen” of Goodwill and “Jimmy” of [REDACTED]. ... Other stakeholders include:

- Inglesia [REDACTED], and Pastor “Rico”
 - Current future employees/clients of Goodwill Costa Rica,
 - Volunteers from [REDACTED] Memorial [REDACTED] Church,
 - Current and future investors,
-

- Employees of Goodwill Industries of [REDACTED]
- Goodwill Industries International.

Assumptions

[REDACTED] The initial funding of \$10,000 is maintained in an account at [REDACTED] Memorial [REDACTED] Church and can be transferred to Goodwill Industries of [REDACTED]

- Donations and supplies needed to start a retail operation will be funded through Goodwill Industries of [REDACTED] and additional Goodwill investors throughout North America and will be available in spring of 2007.
- Volunteers will be utilized to establish the operations in Costa Rica and train the staff to sustain operations.
- All funding will be based on donations.
- Transportations of goods and volunteers are needed to establish operations to Costa Rica.

Issues

- Additional funding will need to be obtained to begin work on this project. A budget should be established.
- ...
- It should be determined how much involvement is needed and wanted from Goodwill International.

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OLIVE GARDEN AND THE PLAYBOY CONTEST

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This case was prepared by the authors and is intended to be used as a basis for class discussion. The views represented here are those of the case authors and do not necessarily reflect the views of the Society for Case Research. The authors' views are based on their professional judgment.

Introduction

Michele Kay, Executive Vice President of WPP Group's Grey advertising firm, which handled the Olive Garden account, sat at her desk contemplating her options. She had just hung up the phone with Olive Garden's president, having learned that Playboy was sponsoring a sexiest "Girls of Olive Garden" contest. Playboy had issued a press release, and the announcement had been broadcast nationwide. Given Olive Garden's hard-earned image as a wholesome family dining establishment, this could be disastrous for the brand.

It all started with Kendra Wilkinson, one of the three well-endowed, blonde stars of "The Girls Next Door," the popular TV show on the E! Network produced by Playboy. On the show, Ms. Wilkinson proclaimed her love of Olive Garden, and personally convinced her boyfriend, Playboy's founder Hugh Hefner, to create the contest. The prize was a nude Playboy pictorial, and Ms. Wilkinson was planning to take the contestants' photos herself (Dana 2008).

Olive Garden spent its history trying to build its brand, since its inception in 1979. On one hand, Kendra's efforts brought the company priceless publicity which could normally not be easily purchased. On the other hand, was this the kind of publicity the brand needed? Michele wondered, "What should Olive Garden do?"

History of the Company

Olive Garden was one of the flagship casual dining chains of the Darden Restaurant group. The restaurant chain began in 1982 as part of General Mills as a single unit focusing on the casual-Italian market (Johnson, 1987). The chain grew quickly in the 1980's and in a market of mom and pop Italian restaurants, Olive Garden emerged seemingly overnight as the dominant chain in this growing segment. The chain was positioned as a restaurant that served good Italian food at a reasonable price, while at the same time offering a festive dining experience. In 1994, Olive Garden became one of the restaurant chains spun off by General Mills to form the freestanding company that became Darden (Romeo & Norvell, 1995).

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By the mid-1990's, Olive Garden had grown to hundreds of restaurants nationwide, but was experiencing competitive pressures as Americans' tastes grew more sophisticated. Management implemented a multi-pronged change in strategy, encompassing substantial changes to its marketing mix. The chain updated its venues using an Italian designer to include classic Italian elements, such as a piazza layout suggesting a traditional Italian public square, and a wood-burning pizza oven visible to guests as they enter. The menu was updated to broaden appeal, reducing reliance on traditional red sauces and adding exciting new dishes such as 'Mediterranean Garlic Shrimp' and 'Capellini Pomodoro'. Executives also revamped the company's promotional efforts, implementing its first national campaign and raising its total advertising expenditures from 3.5% to 6% of sales (Romeo & Norvell, 1995).

By 2008, Olive Garden had 647 units catering primarily to families with mid-priced menu items, Italian-themed interiors, and largely suburban locations, making it the industry's top Italian-themed chain restaurant. The chain was highly profitable, celebrating fifty-five straight quarters of same-restaurant sales growth -- a measurement of sales growth not including newly-opened restaurants -- and profits of over \$3 billion, an increase of 10% over the previous year (Hoover's Inc., 2008). Seventeen percent of all people in the U.S. over age 18 indicated that they had visited Olive Garden in 2007, with close to sixty percent of its customers being female. Women were 27% more likely than men to be frequent customers. While the chain was especially popular among younger people and families, it appealed to a broad base of ages. It was a well-educated customer base, with sixty-six percent having attended at least some college and thirty-three percent in professional, management, business, or financial occupations. Sixty-one percent were married; twenty-three percent had never been married (Mediamark Research, 2007).

Through the years, Olive Garden worked hard to establish and protect its image as a wholesome family dining establishment. The chain coined the term "Hospitaliano" to demonstrate the restaurant's commitment to offering a comfortable, home-like setting where guests are welcomed like family and receive warm, friendly service. Olive Garden ads featured young professionals, couples, and families, accompanied by upbeat music, incorporating the tagline "When you're here, you're family." In June 2008, Olive Garden was named by consumers as one of the top three destinations of choice for casual dining. (Anonymous, 2008d); Quick Study 2008). In a 2008 survey, Olive Garden held the second-place brand leadership position among teenagers in the food establishment category (Anonymous, 2008a).

Olive Garden leveraged its brand's success among families by supporting philanthropic activities like its annual 'Pasta for Pennies' fund-raiser for the Leukemia and Lymphoma Society and the national 'Pasta Tales' essay-writing contest. For 'Pasta for Pennies', students collected spare change, with the class collecting the most funds in each school receiving a pasta party courtesy of Olive Garden. The 'Pasta Tales' contest asked school-age students to describe their favorite family activity, with winners receiving a savings bond and a family trip to New York City, complete with dinner at the Olive Garden in Times Square.

Along with investment in its family image, Olive Garden continued to innovate in business operations, establishing the Culinary Institute of Tuscany, a research and training facility in Italy for its chefs. The company's website included an extensive overview of the Institute, along with recipes and video demonstrations of some of Olive Garden customers' favorite dishes such as 'Tuscan Garlic Chicken', 'Chianti Braised Short Ribs', and 'Shrimp and Asparagus Risotto.' Between demonstrations of cooking techniques for producing the best risotto, Senior Executive Chef Paolo Lafata explained the importance of purchasing quality ingredients like the best Italian olive oils (Olive Garden, 2008). According to Bryan Elliott, restaurant analyst, "Olive Garden has found the right balance between cutting edge and traditional dishes – a balance that allows the company to continue to drive frequency [of customer visits]" (Rogers, 2007).

Darden viewed the continual building and enhancement of its brands as critical to its long-term strategy for success, hiring great brand-builders and investing substantial resources to support them. Darden expected these leaders "to continuously increase brand relevance – and as a result, guest loyalty – by successfully developing and executing strategies that enhance both the positioning and delivery of the brand." Dave Pickens, President of Olive Garden, noted "We're proud of our strong brand and the results we have achieved"

Kendra Wilkinson, 'The Girls Next Door,' and The Playboy Contest

Executives at Olive Garden were taken by surprise when they were informed about the statements being made by Kendra Wilkinson on the E! TV channel program and about the contest sponsored by Playboy. Michele Kay refused to discuss the matter with the press saying only, "I don't feel comfortable talking about this because it is a complicated issue for the brand" (Dana 2008).

"The Girls Next Door" was a reality TV show which followed the daily lives of Hugh Hefner's three curvaceous blonde girlfriends, who lived in the Playboy Mansion. The popular TV show – the highest-rated show on the E! TV channel (Lafayette, 2008) – was just completing its fourth season and was watched by an estimated 1.4 million viewers each week. Seventy percent of the viewers were women, and some customers did not hesitate to express that they saw a bit of themselves in the young female stars. For example, Lindsay Leonard, a dedicated fan of "The Girls Next Door" and a recent graduate of Fordham Law School was quoted as saying, "The show highlights their achievements and education, and overall I think that they're strong women in their own right. For me, it brings a certain amount of respect to the table to see them making the choices they make and taking advantage of the opportunities that come their way" (Kaplan, 2007).

On the show, Kendra Wilkinson described her fondness for Olive Garden and extolled its food, mentioning their artichoke dip and all-you-can-eat salad and breadsticks. Her comments were made repeatedly and came to be associated with Olive Garden's 'new spokesperson'. When the media discovered this passion of the latest of Hugh Hefner's girlfriends, Kendra told the reporter, "I love the Olive Garden so much because I grew up going there. That used to be the place we would go for Mother's Day, for birthdays. My grandpa just died, and right after his funeral, we went to the Olive Garden" (Dana, 2008).

E! viewed itself as the TV channel of choice for adult consumers craving programming on celebrities, entertainment, and pop culture, connecting these consumers to the world of Hollywood in a “positive, fun, witty, and aspirational way” (E!, 2009). E! had one of the highest viewership concentrations in cable TV of young, college-educated, upscale, professional adults ages 18-49 with a household income greater than \$75,000. 64% of viewers had attended college, with 28% graduating and 12% still attending (E!, 2009). The show’s popularity among women ages 18-34 took the network by surprise, as “The Girls Next Door” had been expected to take place of the departing “Howard Stern Show,” whose viewers had largely been men (Lafayette, 2008).

While she listed Olive Garden’s owner on her popular *MySpace* page as one of the people she would most like to meet, Kendra Wilkinson told a reporter that she never considered what the company’s marketers might think of her comments (Wilkinson, 2008). “I don’t speak about it to get paid for it,” she says. “I speak about it because I love it. I understand they’re a family restaurant, but I think it can’t hurt them to have a little spice” (Dana, 2008).

As for the Playboy contest, Kendra responded, “Not only is Olive Garden my favorite restaurant, but I always notice how cute the staff is. I look forward to finding the sexiest employees and giving them the opportunity of a lifetime” (Anonymous, 2008b).

Not all who viewed ‘The Girls Next Door’ were enamored of the program. The Florida Family Association, an organization whose mission was to “improve and protect our moral environment” (Florida Family Association, 2009), encouraged its members to mount email campaigns to companies advertising on ‘The Girls Next Door,’ influencing over 340 advertisers to stop advertising on the program. The Florida Family Association, a 501C3 company with a mission to promote “family values,” noted the program “frequently contains scenes involving nudity including the shooting of pictures for Playboy magazines and footage for Playboy DVDs” (Unruh, 2009).

What to Do?

Michele McKay and the Olive Garden executive team were left in a quandary. Generally, this kind of adulation was the enviable mark of brand loyalty, but in this case, they were not so sure. The company had invested years of effort and countless millions of dollars in the Olive Garden brand, appealing to parents, grandparents, and families, and the questionable association of Playboy could have a substantial impact on their investment overnight. The “Sexiest Girls of Olive Garden” contest was garnering nationwide publicity, including a front-page article in the *Wall Street Journal*. Should they welcome Kendra Wilkinson as an Olive Garden spokesperson and embrace the Playboy contest? Should they actively try to disassociate Olive Garden from Playboy? Or, should they do nothing at all?

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SCR**THE SOCIETY FOR
CASE RESEARCH**

P. DIDDY GOES THE DISTANCE

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This case was prepared by the author and is intended to be used as a basis for class discussion. The views represented here are those of the case author and do not necessarily reflect the views of the Society for Case Research. The author's views are based on the her professional judgment.

The Incident

Alison, a psychology professor at a large metropolitan university, returned to her office after a five day vacation, signed onto the computer and started reading the work and non-work emails in her very full in-box. When she started reading the non-work related emails she found that people she didn't even know had responded to an email she had forwarded while at work, before her vacation, to a couple of her Saturday morning running buddies (See Email 1). The email was from a friend, who was training with her for the NYC marathon, about a recent entrant in the Marathon. At the time, she had thought the email was extremely funny. She had been training hard for the Marathon for eight months and the email was about the training schedule of a celebrity. Judging from the responses not everyone thought the email was funny, and to make matters worse, some people had even found it offensive. In addition, after reading the chain of responses she realized that her email was forwarded through several list-servers and literally thousands of people may have read the message she had forwarded and the responses it had received. She realized that over five days, as the email made the rounds, some people may have read her message not once or twice, but up to ten times - with her name, position, title and organization included each time a reply was posted or the email was forwarded. As she looked at her in-box she wondered how she had gotten into this situation and what she could do about it now? And more importantly, what would be the consequences for her at work?

Background

The city Alison worked in had a vibrant running community. Usually people found out about the various running groups by talking with an owner of one of the numerous running gear stores in the area or through the internet. The local running web site listed over 22 running clubs in the city and surrounding area. Most groups had an Internet presence. However, some groups had a wider and broader reach than others. Many communicated via a list-server for runners. Runners

got to know people when they went out to run with them or when they read postings to the group. Groups regularly met at various places during the week or on weekends to run together and frequently ate together afterwards. The groups were very informal and open to runners of different ability levels. Many “members” were training for marathons, but some were just venturing into running, and others ran shorter 5K races. So it was not uncommon to find the joggers, runners, and marathoners out on the road together. It was also rare not to find a new face each week. But each group had its “core” members – the regulars – a smaller group of close-knit runners.

Introduction

Rap Artist Sean ‘P. Diddy’ Combs decided to celebrate his birthday by running the 2003 New York City Marathon. His goal was to raise \$1million dollars for charity to help needy kids. Some of the money would go to the New York Public School system and the rest would go to the charity he started in 1995, Daddy’s House. He launched a marathon web site to support his fundraising efforts, Diddy Runs the City. He didn’t realize that his decision put him into an elite group – that less than 1% of the general population have ever trained for and complete a marathon (26.2 miles). Marathonguide (<http://www.marathonguide.com/features/articles/2003RecapOverview.cfm>) reported that only 334,000 people have ever completed a marathon. Sixty percent of marathon finishers were male and 40 percent were female. Ninety-nine percent of all runners who run marathons are white and one percent is black. The average finishing time for all marathoners is 4:41:59 hours.

The Emails

The message Alison sent is Email Number 1 in which she forwarded the email from her friend, Paul. The list server that Paul sent the message to had approximately 700 members and the list server that Alison forwarded the email to had over 300 members.

Email Number 1:

-----Original Message-----

From: Tall, Alison [<mailto:abtall@university.edu>]

Sent: Tuesday, September 30, 2003 1:55 PM

To: [SecondRunningGroup @yahoogroups.com](#)

Subject: Second Running Group Mailing List P Diddy

Hi Everyone, this was just forwarded to me (see below)... I am cracking up.
Maybe we've been doing it wrong all those early, long Saturday mornings! ;-)

Alison

-----Original Message-----

From: Paul [<mailto:paul@yahoo.com> <<mailto:paul@yahoo.com>>]

Sent: Tuesday, September 30, 2003 1:49 PM

To: FirstRunningGroup@yahoogroups.com

Subject: [FirstRunningGroup] This from Paul

Just think, if this clown can do it, anyone can. I think he's giving up the partying a little early though.

True story I heard on Fox News Radio.

Sean "P Diddy" Combs, aka Puff Daddy today announced he will be running in this years NYC Marathon. Attempting to raise over one million dollars for charity (inner city children) and being called 'Diddy in the City', Sean said his goal is to beat Oprah's time of 4:29:15 (Marine Corps Marathon). When asked specifically what time he predicts to finish the grueling race, Sean claimed "under four hours." He said his training started "about three weeks ago" and he's been running "a couple miles a day." The rapper indicated he will give up partying "next week." Sean also said he will not be running w/ his usual entourage but w/ "my peeps from New York." ...He should have run the 'Race at the Ridge' as his long run.

--Paul

Alison Tall, Ph.D.
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The second and third emails were from local runners. In email number 3 the respondent agrees with the post from email number 2.

Email Number 2:

On Thursday, October 2, 2003, at 09:20 AM, Carson Louise wrote:

Hi everyone,

I like p.diddy and I think it's great that he is doing his part to help these inner city kids who have had a rough life and don't get to enjoy the things that many kids in the States do. P. Diddy actually does work out on a daily basis and also runs long distances like all of us. He has been featured in many African American publishing's that have wrote about his athletic abilities and what he has accomplished. SO, I didn't find it funny at all. He is not a CLOWN. Regardless if he finishes the race or not he has helped thousand of inner city kids have a better future and that is what should be the focus.

Please in the future, when emailing things like this, remember that there are African Americans also on this list that are apart of the NCR Trail Snails that may take these things offensively.

Thank you for being understanding everyone,
Louise

Email Number 3:

>>> Marion<Marion@mac.com> 10/2/03 2:01:23 PM >>>

Hey Louise!

I just want to chime in on this issue--I think you are totally right. I had the same reaction when I read the email below. I am completely new to this group (and to the Baltimore area) so I hesitated to make this my first contribution, but then I thought I just wanted to make sure you knew you weren't alone.

I concede the writer probably did not mean offense, but ignorance is 9/10 of the law, right? P.diddy is KNOWN for his incredible fitness, and beyond that, as a marketing professional in the athletic business, I KNOW that running and running events need all the positive PR they can get. And he, like Oprah before him, is guaranteed to bring lots of that to the day. I do not think he is trivializing the work it takes to train for one of these, as much as he is underscoring the great and positive effect that running these events can have on the community.

Thanks for sounding in on this!
Marion

In email number 4 a runner posts her own comment and also forwards an email that she thought was relevant to the topic being discussed. This email included an additional list server with 2500 members.

Email Number 4:

My 2 cents and a repost from the Store's Running Newsletter

10/03/2003 7:36AM

Beloved [Second Running Group],

We as [2nd running group] (of every flavor) tend to be the first ones to *not* knock someone (we know nothing about) on an athletic attempt. I am sure people look at me and think "She is going to run 50 miles? Yeah right!!!" This is a group with the mentality that everyone can accomplish what they set their mind to. It is one of the reasons I hooked up with you all. Normal (well, maybe) people accomplishing amazing things.

That said, let's not let this spiral. Sometimes people hit the send button without thinking things all the way through. (happens to me ALLLLLLL the time! - like maybe now.....)

Peggy

From: "Running STore" <Store@abc...>
Date: Tue Sep 30, 2003 10:35 pm
Subject: P. Diddy's NYCM Run

In some circles there has been some wonderment and consternation that The performer now known as "P. Diddy" has announced an intention to run the New York City Marathon. A friend of mine is coaching this individual, And I thought I would pass along his observations:

From: "Ned L. Cooke (Personal Mail)" <Ned.L.Cooke@M...>
Subject: Re: Disturbing marathon news

I tend to agree with Parker. But, here in the Big Apple the NYCM has lost it's ability to get press coverage. Sean, and yes I call him Sean, is sincere about his marathon attempt. He's raising money for three charities for kids (<http://www.diddyrunthecity.com>) Daddy's House Social Programs, Children's Hope Foundation and the NYC Public Schools (libraries and technology). Say what you want about him, he's Extremely serious about this. Yes, he's getting lots of GOOD press from this, But he keeps going back to the kids, wanting the money raised to go to the kids, wanting to see the benefits first hand, not just the checks. I started this project with grave doubts and concerns. As a coach I wondered if he was serious. As a New Yorker I wondered if this was just a PR gimmick and I wondered what he was really like - up close and personal.

Anyone starting to train for a marathon with less than 12 weeks to prepare, leaves huge issues and pitfalls. Sean hasn't become a successful business enterprise by taking bad risks or not being focused and committed. When he ran 13 miles two weeks ago along the Hudson River Park, at an 8:30 pace I began to believe in his ability to Finish the marathon. When he returned from Oregon and Nike (meeting with Alberto Salazar) and announced he wanted to run the marathon in four hours I had my doubts again. But, this past Saturday he ran 17.6 miles at around a 9 minute per mile pace on an extremely hilly course (he dropped his personal trainer before the big hill and turnaround point) I was convinced he would finish the marathon and had a shot at running faster than Oprah did (he's asked about her time).

Sean is a business man. He takes advantage of opportunities. This is a good PR opportunity for him. But, it's also a big physical and personal challenge. And, isn't that what the marathon is all about - setting a goal and meeting the physical and personal challenge? Climbing a 9% grade for one mile in the middle of a 17+ mile run, I got to see his willingness to suffer and keep going. He didn't walk one step the entire run Saturday. I know I walked during my first long run.

Say what you want to about him as an artist, business man, person. Come late in the day on November 2, 2003 I believe he will also be called a marathoner.

Running NYCM is a challenge, there are parts of the course that are jammed with people. But, there are also parts of the course that are pretty empty and they tend to be the parts that are the most difficult - 20 mile mark. I believe Sean's running the NYCM will bring people out along sections of the course that are typically empty.

Stay tuned.

Ned L. Cooke

NLB Coaching & Training Systems

The writer of the 5th email replies to all but addresses it to the writers of emails number 2 and 3.

Email Number 5:

On Friday, October 3, 2003, at 09:17 AM, Julie wrote:

Dear Louise and Marion,

Far from criticizing a fellow runner for posting this "news" item, you should be praising her. She's spreading the word - word-of-mouth (the best kind of) publicity. My opinion, but this is a media event that P. Diddy wishes to capitalize on for the benefit of inner city kids. Growing up as a poor inner city kid myself, I can appreciate that. If not for the recent post, I would have known nothing of his campaign. Call me ignorant but I do not know who P. Diddy is, nor am I aware of the color of his skin. We are well beyond the days when rappers are assumed to be African American.

If you wish to talk about this with me some more, join me on the Trail for a twenty miler tomorrow, and we can discuss it the whole way. We're all runners after all. (Others Slugs will be at Lake Crow)

Julie

In Email Number 6, the writer of Email Number 3 responds to the writer of Email Number 5. The email is sent to all previous recipients.

Email Number 6:

10/03/2003 9:22AM

--- Marion <Marion@mac.com> wrote:

Julie,

couldn't agree more: there is no such thing as bad PR! So thanks to the person who originally posted this, and thanks to Louise to have the courage to broaden our perspective on it and turn into something we could think about not, not just chuckle smugly to ourselves about.

cheers.

Marion

Emails Number 7 and 8 are sent by people who had not previously posted on this topic.

Email Number 7:

Date: 10/3/2003 9:47 AM

I think the point was that we have a serious training plan over several months to achieve the goal of "finishing" the marathon and, in many cases, coming no where near 4 hours. It wasn't really laughing at P Diddy, it was laughing at the idea of just starting to train 3 weeks ago, stop partying for a few weeks and running 4 hours in a marathon for the first one. Of course, we all

think it is great for someone famous to set such a goal to raise money for inner city kids, but the lack of training with such hefty goals in the marathon "by itself" is actually kind of funny to me too. LIGHTEN UP!

I'm not sure how old P. Diddy is, but a younger person can certainly do it. But if Sam took us every year and said that our training program is the same as P Diddy's,, we would all laugh!
Chuck

Chuck Middleton
1248 New Way Road
AnyCity, AnyState 99999
(W) 102-345-6789
(C) 234-567-8901
(H) 456-789-0123

Email Number 8:

Date: 10/5/2003 9:03 AM

Louise,

your point was well taken, I don't know much about p diddy, other than an article or two in newsweek. I saw the post that said he was training and actually said he was doing pretty well. If he raises money or puts his own money up for charity, more power too him.

I don't know who wrote the post that busted on him, but not everyone agrees with that point of view. You are right to call out the snails when they are insensitive or wrong. I would support your point of view on the snail site, but I can't post replies for some reason.

Kyle Dillan
dilkyl@earthlink.net

Alison couldn't believe that with the stroke of a key she had created such a response. Her vacation was clearly over. What should she do now? Could she safely ignore the mess since it seemed to be over and she didn't know any of these people? What would happen if her department chair, or some other university administrator found out – would she be in trouble? How could something that seemed so small and even funny at the time suddenly look so different?

Five years later, October 18, 2008 another e-mail was posted to same list-server.

Email Number 9:

From: "John Howard" <howardjohn@comcast.net>
Date: Sat, 18 Oct 2008 20:33:20
To: <SecondRunningGroup@yahoogroups.com>
Subject: Second Running Group Mailing List safety

Second Running Group,

I have been doing some thinking about our yahoo list emails. As you all know, I am a bit of a safety geek and tend to look at what could go wrong. With that being said, may I suggest that we may be getting a little lax in our correspondence. Thinking we are always dealing with close friends, we freely advertise when we are out of town, our phone numbers and addresses. Some of us (I am guilty) use the list to let others know that we are doing a late night or solo trail run. Our yahoo list is public with over 300 subscribers. This is slightly larger than our little Saturday morning breakfast club! While I am sure most of our "lurkers" are good people. There may be a bad one in the bunch. Just remember that anything posted on the Yahoo list is in the public domain. Let the flames fly.

John

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PHOENIX MAGAZINE

Nancy E. Kucinski, Hardin-Simmons University

This case was prepared by the author and is intended to be used as a basis for class discussion. The views represented here are those of the case author and do not necessarily reflect the views of the Society for Case Research. The author's views are based on her professional judgment.

Ken Martin, founder, publisher, and editor-in-chief of the free Phoenix Magazine had seen the writing on the wall during November, 2004 when he looked at his declining advertising revenue numbers. Ken knew he had to move his London, Ontario based music, art and news magazine away from its original target market of young, hip readers to a more mainstream audience. Ken needed to implement a new marketing approach for Phoenix Magazine, but how was the question facing him.

Phoenix Magazine Background

In 1989, Ken Martin knew he wanted to be an entrepreneur. He also thought he wanted to buy a company, improve it with his management skills, and flip it for a profit. He also knew that London, Ontario needed a publication that provided coverage of the local music and arts scene. As a musician, Ken knew what exposure meant to musicians and artists. He believed that a locally published magazine would address a need in the community that was not being met by the major local newspaper or any other publication. By launching Phoenix Magazine in 1989, Ken believed that he had really made a difference in the community, and he had met the goal of owning a successful business. The magazine played a role in the success of musicians and artists, local businesses, restaurants and bars, by attracting the attention of record label executives, music and arts festival directors, and the public.

After 16 years of running the magazine, Ken thought he was on the right track to accomplish his goals. Even though the combined jobs of publisher and editor-in-chief required 17 hour days, he felt that he had settled into a way of life that satisfied him, at least for the present. He was open to selling the business, but it had to be to the right buyer. He had turned down offers from the major London paper in previous years, because the whole reason for creating Phoenix Magazine in the first place was to satisfy a community need that was not being met. Ken believed that his magazine offered readers entertainment, enjoyment, and well written local, national, and

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international news. Something he believed the local newspaper could not accomplish. The local newspaper was Phoenix Magazine's only competition and Ken believed that the newspaper's approach to art, music and cultural articles did not provide an equivalent product to his own; therefore, selling to the competition was not an option. So much for "flipping," he thought.

The London Scene

The Canadian city of London on the shores of Lake Erie, located half-way between Detroit and Toronto had a population of about 350,000. London was also home to the University of Western Ontario. Because of the young and music savvy student population, live music was an important part of the local culture. There were approximately 70 music and art venues, ranging from large auditoriums for concerts to small house art galleries and restaurants with live music. While London was a college town, the portion of the population aged 45 to 60 increased 16% between 1996 and 2001, and those aged 75+ increased 17.2%. The average family income in London jumped 31% from 1996 to 2001, and home ownership increased by 7,500 dwellings, a 9.2% increase. While homeownership increased in London in 2001, the percentage of single parent families also increased to 11% of London families (a 1.7% increase over 1996). The number of two parent families decreased by the same amount as the growth of single parent families (28.9% in 2001, down from 30.6% in 1996). Between the years of 1991 and 2001, London had a drop in unemployment and a decrease in bankruptcy rates (Social Research & Planning Department of Community Services, City of London, 2004). The demographics for London, Ontario appeared to be growing older with higher rates of home ownership. There was also an increased interest in the development of children and youth services in the City of London, including youth sports facilities, and numerous parks and playgrounds (Community & Protective Services Committee, Parks & Recreation, 2004). The City of London even had public indoor and outdoor swimming pools, along with a children's water park.

In addition to the development of sports and recreation facilities, the City of London offered five festivals. These festivals included an apple festival, an international children's festival, and an independent music and artist showcase festival, as well as community harvest festival and a Mexican festival, all held in the early fall (London Tourist Information Center, 2004).

Phoenix Magazine Business Model

The business model that Ken followed consisted of offering a free newspaper-like publication that was divided into sections encompassing local events, reviews, artist features, and local, national and international news. The Magazine was distributed through boxes that are placed around the city. Revenue was generated by selling advertising to local businesses. Over the years, Ken developed additional advertising sales through a national advertising agency that provided about 20% of his gross revenues. Local advertisers placed ads for events, movie theaters, music stores, restaurants and even a tattoo parlor. Phoenix's national advertisers consisted of automobile manufacturers, alcoholic beverage distributors, tobacco company advertisers, and producers of nationally released movies.

Ken Martin

Ken Martin was a long time resident of London, having received a degree in Honors Business Administration in 1980 and a Masters of Business Administration (MBA) in 1986. Both degrees were from the Richard Ivey School of Business at Western Ontario University. He was divorced and had two daughters that meant the world to him. During his divorce proceedings, he almost lost the ability to be involved in his daughters' lives. He realized that his daughters were what mattered most to him.

Ken had gone through several issues with his editorial staff, but some of Ken's biggest problems began seven years after he founded the magazine when he agreed to allow other people to edit various sections of the magazine. Alice Randall edited the arts section, Linda Bell edited the music section, and Ben Rogers edited news. Ken essentially let these editors have free reign and he experienced difficulties with each editor over several years. The arrangement with Ben created the most long-term trouble. While Ben's duty was to edit news content, Ken's primary responsibility was to sell advertising. A few years into this relationship, Ken began to receive emails and other forms of reader complaints about several news articles containing inflammatory statements about homosexuality, abortion, and prostitution. Ken began to think that the editing arrangement was a mistake. Ben seemed to have his own agenda and aggressively pursued writing articles that gave the magazine a reputation with which Ken was not comfortable. As things escalated, Ken realized that the "hip" magazine that he wanted was actually perceived as a left-wing angry ranting newspaper. Some people thought the magazine published certain articles just to cause trouble, just to raise the hackles of public officials, community leaders and even the average reader. Trouble followed when the magazine garnered such controversy that its reporters were banned from City Hall. Ben had published stories and columns that public officials and the community thought inappropriate and too controversial. As a result, printing even the simplest stories, from crime reports, was not possible because access to police department sources was closed to Phoenix.

Ken also found that other relationships between the magazine and the community had been severely damaged. Sources of information about events and activities in the city began to be hesitant to speak to Phoenix reporters. But, Ken did not realize the seriousness of the situation until the time of his divorce proceedings when he almost lost custody of his daughters. To officials and the community, Ken was thought to be just as much of an inappropriate, left-wing, trouble-maker as his magazine was perceived to be. During the divorce Ken was painted as having harmed and damaged the community. No one was more surprised than Ken, he knew what was in his magazine, but he did not realize the negative impact on the magazine and his personal reputation.

The lesson that Ken learned was not to simply assume that others always have your best interests in mind; editorial freedom cannot be allowed to jeopardize the success of the organization. He also learned that it was vital for entrepreneurs to ensure that oversight processes, performance reviews, and specific lines of accountability were present and formalized within companies. He determined that he would not make that mistake again.

The New Approach

Ken “parted company” with Ben and took over as the magazine’s Editor-in-Chief with final approval for all news stories, articles and reviews. Ken took control of the content of the magazine and began to emphasize quality of writing of the news stories and art reviews. Ken believed that most news outlets did not spend enough time and space analyzing news events. His idea of a quality magazine meant providing in-depth analysis of news, and detailed reviews of music and arts events. He also believed that quality in the production of the magazine was a must, the magazine cover had to look attractive and he tried to feature well known celebrities on the cover.

However, Ken’s problems did not stop with the improved quality of the magazine. One of Phoenix’s most important advertisers, a tobacco company, had pulled their advertisement from the magazine. His sales revenues took a nose dive. Ken had been fearful that this was coming for several years, and it had finally come true. In 1988 the Canadian Parliament passed the Tobacco Products Control Act which banned all tobacco advertising, but because of vagueness and misinterpretations of the law, numerous Court challenges were made over the next 16 years. These Court challenges essentially blocked and delayed the full implementation of the tobacco advertising ban. Most people believed that the ban would eventually be implemented, and consequently the tobacco company that advertised in Phoenix was not interested in taking any chances. For them, it was time to lay low. Ken understood that the tobacco company did not want to risk attracting the attention of officials as the ban was being implemented.

As Ken now studied and analyzed the data from his advertising sales, he came to realize that the tobacco account had been a crucial element of his revenue (see Table 1). There had to be some way to make up the difference in sales, but he was afraid that it would be hard to find a national advertiser that would be willing to place an advertisement in the Phoenix after all of the controversy. The revelations about Ken and his magazine’s reputation during his divorce proceedings struck an important note with Ken. He saw that the need to attract a national advertiser to replace the tobacco advertiser was tied to the need to repair his and his magazine’s reputations. He believed that it was time for his magazine to mature. Ken had matured and so had the population of London. The college scene was still an important part of the arts community, but he believed he needed to reach a broader readership.

It was clear that Ken needed to attract more national advertisers, but advertisers were interested in publications that had a broad readership. Ken decided to move his target market away from the smaller, younger crowd to an older, more mainstream audience. After all, potential advertisers needed a market group with disposable income. To Ken, it did not seem like a difficult decision to change the target market of the company. After his divorce, it was clear to him that he and his magazine had been misunderstood. All he really wanted was a magazine that people could learn from and enjoy. The tough part was implementing his new market strategy.

Table 1
Phoenix Magazine Advertising Sales Revenue % Change from 1999

Year	National*	Tobacco	Local	Total Sales
1999	30.43	0.00	69.57	1.00
2000	25.93	5.80	74.07	1.06
2001	9.04	0.00	90.96	1.20
2002	28.65	14.19	71.35	1.50
2003	20.99	8.65	79.01	1.29
2004	20.31	0.00	79.69	1.26

*includes all national + tobacco

Implementation

Ken believed that implementation was where the “boots hit the pavement.” To be competitive, he could not just lament problems, nor could he merely theoretically decide to change directions. He had to take specific actions to make his magazine one that attracted more advertising revenue. How could he attract the type of readers that national advertisers wanted? He knew it would take time, but he had to start by repairing the damaged reputation of Phoenix magazine and himself.

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POPULIST MAYOR APPOINTS *MINUTEMAN* TO KEY POST

Turner White, Rockhurst University, Kansas City, Missouri**Tom Lyon, Rockhurst University, Kansas City, Missouri**

This case was prepared by the authors and is intended to be used as a basis for class discussion. The views represented here are those of the case authors and do not necessarily reflect the views of the Society for Case Research. The authors' views are based on their professional judgment.

A “Perfect Storm” of Civic Crisis

Six weeks after his inauguration as mayor of Kansas City, Missouri, Mark Funkhouser appointed Frances B. Semler to the powerful five-member Kansas City Parks and Recreation Commission. He was not aware that Semler, a 73-year-old grandmother, was a member of the Minuteman Civil Defense Corps, a controversial activist anti-immigration group (see Table 1). At the time of her appointment, little was publicly known about Semler's civic interests, which was atypical for such a high-visibility appointment. Funkhouser had left himself vulnerable to criticism.

Mayor Funkhouser's appointment had pushed simultaneously the national hot buttons of immigration, social justice and racism. As the situation escalated, these issues became problematic for the Kansas City plan to build a national reputation and court a national market for conventions and visitors through new public and private investment of \$3 billion.

The Mayor's Role

Kansas City's form of government is that of a City Charter that designates a mayor who leads a city council and together they govern through a city manager. In this so-called “strong city manager” form of government, the mayor and the council establish broad outcomes for city development; set the tone for the city's image in the region, state and nation; and, ensure accountability of government. The mayor appoints members of standing commissions and committees.

Mark Funkhouser

Mark Funkhouser grew up in the hills of West Virginia. He earned a bachelor's degree in political science from Thiel College, a master's degree in social work from West Virginia University, an M.B.A. from Tennessee State University, and an interdisciplinary doctorate in public administration and sociology from the University of Missouri-Kansas City. Funkhouser began his career as a social worker. He became an auditor, first in Tennessee state government and then in city government. He was the city auditor of Kansas City, Missouri from May 1988 until he took an early retirement in November 2006.

In his years as Kansas City auditor, Funkhouser had been considered a strong advocate for the citizens of Kansas City. His reports had focused on enhancing basic city services. Examples include audits on street maintenance, the Kansas City Police Department, street lighting and the Parks Department. His audits had also focused on sound financial stewardship.

Even though Funkhouser had no prior political experience and had never run for public office, he ran for mayor on a populist platform and was elected mayor in March, 2007, and sworn into office May 1. He won by less than one percent of the popular vote, by defeating the popular, long time mayor pro tem of the city.

Crisis Grows as Emotions Swell

The mayor and his wife, who was his volunteer chief of staff and adviser, first met Frances Semler during the mayor's campaign in the suburban north section of the city – a stronghold of support for the mayor. But, as the *Kansas City Star* editorialized, "... Funkhouser failed to properly research her background..." Typical of political appointments, a process of vetting candidates by a combination of civic leaders and political advisers loyal to the Mayor was a customary practice of his predecessors.

As the criticism gained momentum, the Kansas City Council, with whose members the mayor must work daily, voted 9-3 to adopt a resolution calling for Semler's removal. The mayor refused, and Semler added later, "I don't intend to resign."

Local newspaper and television stories followed the controversy. *The Wall Street Journal* picked it up, and Fox News planned a national story on the subject. Kansas City councilwoman Beth Gottstein was quoted as saying, "This is one step from the KKK..."

The repercussions of the Frances Semler appointment continued when the national Latino advocacy group, the National Council of La Raza (NCLR), threatened to withdraw its commitment to Kansas City for its national convention in 2010 unless the newly-appointed commissioner resigned or the mayor demanded her resignation. The convention was expected to attract an estimated \$5.5 million and an attendance of 4,000.

The mayor refused to withdraw the appointment or to accept Semler's offer to resign citing his commitment to his principles without further elaboration.

The situation became more embroiled when the NAACP threatened to support La Raza by withdrawing its planned national meeting in Kansas City in 2009.

Supporters of Semler made themselves known when the national Minuteman organization scheduled a two-day national meeting in Kansas City following the publicity about the issue. Its attendance was expected to be 300.

In the midst of the threats and accusations, the mayor's wife added more fuel to the already boiling controversy. Elected on a populist platform, Mayor Funkhouser had refused to use the professional driver and police bodyguard that had been a fixture for every mayor in recent memory. He preferred to drive himself to events. A community forum that included Mayor Funkhouser was called in the city's largely Latino sector to discuss the Semler-Minuteman situation. As preparations for the meeting mounted, the mayor's wife/chief of staff called the police chief to ask him for a police escort to the forum. This move offended the Latino community and its leadership.

The already strained relationship with the Latino community in Kansas City was summed up by long-time leader Chris Medina who told *The Wall Street Journal*, regarding the entire controversy, "This is a slap in our face."

In an attempt to calm the waters for Funkhouser, a public relations story appeared in the *Kansas City Star* to create a kinder, gentler image of Mayor Funkhouser. A picture appeared in the paper of the mayor kissing his wife in his City Hall office. Despite these efforts, the controversy over the park commissioner appointment and the threat of La Raza and the NAACP to move their conventions from Kansas City continued to dog the mayor (see Table 2 for a time line).

The Mayor's Decision

Mayor Funkhouser faced a public crisis. His response would impact local race relations, the attraction of visitors and conventions to the city, and Kansas City's reputation locally and nationally. "This decision has far reaching implications..." incoming chairman of the Kansas City Convention and Visitors Association and civic leader Bill Lucas told the *Kansas City Star*.

Despite the growing pressure for action, the mayor decided not to intervene and attempted to allow the controversy to subside. Yet, the issue continued to thrive as minority and special interest groups kept it alive. The number of interested and involved groups grew to include business people whose stake in Kansas City's convention and meetings market was threatened. (This is an analytical comment that could be left for students to conclude.) The mayor had few close advisers to whom he could turn for counsel, or to act as advocates in reaching a

compromise among the various stakeholder groups. Clearly, he had a problem and it appeared that inaction was not a viable decision.

Table 1: The Minuteman Civil Defense Corps

The Minuteman Civil Defense Corps stated mission is *“To secure United States borders and coastal boundaries against unlawful and unauthorized entry of all individuals, contraband, and foreign military”*.

The Minuteman Civil Defense Corps, a group headed by Chris Simcox, is dedicated to preventing illegal crossings of the U.S. border arguing that the government is not sufficiently concerned with securing the U.S. border. The national organization has organized several state chapters with the intention of providing law enforcement agencies with evidence of immigration law violations. The organization has been criticized as being a right-wing militia.

<http://www.minutemanhg.com/hq/>

Ed Hayes, Kansas Director of the Arizona-based Minuteman, was quoted in the *Kansas City Star*: “The border is no longer in the desert. It is all over America, especially in Kansas.”

Table 2: Controversy Time Line

Mar 27	Mark Funkhouser elected Mayor of Kansas City, Missouri by a margin of less than one percent.
May 1:	Sworn in as mayor
Jun 11:	Frances B. Semler appointed to five-member Parks Commission
Jun 12:	<i>Kansas City Star</i> reported that Semler was a member of the Minuteman Civil Defense Corps.
Jun 14:	Local NAACP, Coalition of Hispanic Organizations, and Southern Christian Leadership Conference denounced the appointment. Kansas City Council Voted 9-3 to adopt a resolution that Semler resign. Mayor refused to fire Semler.
June 28:	Mayor met with Latino community leaders to attempt issue resolution; it failed.
Jul 16:	National <i>Wall Street Journal</i> story appeared front page, B-section.
Aug 30:	National Council of La Raza threatened to cancel \$5.5 million, national convention with 4,000 visitors.
Sep 6:	NAACP, in support of La Raza, threatened to reconsider its \$10 million, 14,000-person national meeting, if the issue wasn't resolved favorably. Semler told the <i>Star</i> : "I don't intend to resign."
Sep 7:	<i>Kansas City Star</i> called for Semler's removal in a lead editorial.
Sep 14:	Minuteman Civil Defense Corps announced its national convention in Kansas City. US Rep. Emanuel Cleaver (D-Mo.), a former mayor, told the <i>Star</i> , "This is getting uglier than any of us expected."
Sep 16:	<i>The Kansas City Star</i> editorialized about Funkhouser, "Early Successes Deserve Attention."
Sep 18:	Funkhouser told a <i>Kansas City Star</i> columnist, "You shouldn't abandon your principles just because somebody has opposed them." He didn't elaborate further.
Sep 25:	Kansas City Convention and Visitors Association formally asked mayor to act to restore Kansas City's reputation.
Oct 9:	The <i>Kansas City Star</i> , in an editorial, asked Semler to resign.

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CASE RESEARCH**

PORNOGRAPHY AND THE UNIVERSITY COMPUTER

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This case was prepared by the authors and is intended to be used as a basis for class discussion. The views represented here are those of the case authors and do not necessarily reflect the views of the Society for Case Research. The authors' views are based on their professional judgment.

Introduction

It was a Friday afternoon on a beautiful fall day in Idaho. Mary Anne Baldwin, Director for the Center for Health Education at Western Idaho University (WIU), had just returned to her office from one of the regional offices when her phone rang. Baldwin thought this was odd. Few university employees were in their offices on such a beautiful Friday afternoon, and any work oriented conversation could probably wait until Monday.

Nonetheless, Baldwin answered her phone and she received the news that Chloe Howell, a health educator employed at the Center for nine months, allegedly had been using university equipment to engage in pornographic activities. Specifically, Theresa McCall, the Education Supervisor, had called Baldwin to explain that she had taken Howell's laptop computer by mistake and, when she opened files on the computer, she found suspected pornographic material.

McCall explained to Baldwin, "When I logged on, I found pictures on the computer that showed Chloe undressed and posed in sexually provocative positions. I then opened more files and found saved Internet chat room discussions about sex between her and several men. Frankly, Mary Ann, this upsets me."

McCall noted that Howell had been taking the university's laptop computer out of the office. However, this was normal practice so that educators could have access to their computers while offsite from the main campus. Both Baldwin and McCall speculated that Howell, while away from the office, might have attached a camera device to the computer and then, posted her photos on the Internet.

Baldwin thanked McCall for letting her know about the situation. After she ended the phone conversation, she hung up the phone and paced around her office. She considered what she should do now. In particular, Baldwin was concerned because she did not have official university policy or procedure to guide her. There was no official State of Idaho or WIU policy regarding state employees' personal use of computers. Nonetheless, Baldwin thought one's engaging in this behavior was not appropriate. Further, she assumed that other professionals knew not to use university equipment for pornographic activity. What should Baldwin do now?

The University Center for Health Education

The University Center for Health Education was a relatively new initiative for the College of Health. It had been established 18 months ago, and was staffed by healthcare professionals who offered continuing education seminars, workshops, and lectures to healthcare professionals around the State of Idaho. These healthcare educators took their laptop computers, power point lectures, and handouts to deliver education programs at healthcare professionals' workplaces. The purpose was to provide up to date healthcare information that enhanced healthcare providers' continuing education. The mission of the Center was as follows:

The mission of the University Center for Health Education is to provide high quality continuing education for health professionals in all regions of Idaho to enhance the public health of Idahoans.

The Dean of the College of Health Professions at WIU was pleased with the Center's efforts to date. Specifically, the Center fit well with the College's mission to develop leadership in healthcare and enhance the quality of life in Idaho. Furthermore, the continuing education training the health care educators provided brought in additional revenue for the College (\$800,000 was projected for its first two years). The Dean supported the Center because it helped fulfill the education mission of the college, and it brought in extra revenue. The Dean was often quoted saying, "The Center has fit well with our mission to provide community service to our State while providing a way to enhance the quality of life for Idaho residents."

The Hiring of the Center Staff

Baldwin's main responsibilities had been to establish seven Center offices around the State and hire the professional staff--22 Health Educators, three Health Education Supervisors, and eight Administrative Assistants--within the 18 month timeframe. Baldwin traveled extensively around the state and, working with the University Human Relations (HR) department, first hired the Health Education Supervisors. Second, working with the Health Education Supervisors and the University HR department, the 22 healthcare educators were hired. These decisions were team based decisions, and Baldwin knew that it was critical to the success of the Center to hire staff members who were well-trained and professional. The health educators worked in various locations around the State of Idaho and they were not supervised on a day to day basis. Hence, great care was taken to ensure that they hired the best possible staff.

The WIU HR department did have a written policy that new positions had to be approved by the University Administration and State Board of Education. Baldwin had followed this process and had received the necessary approvals to create the health educator positions. There was no WIU HR written policy regarding the hiring *process* for the staff. Through conversations with HR officials, Baldwin had learned that an individual should not make a hiring/firing decision by him or herself. Thus, all HR decisions that affected an employee's working status at the Center were the result of a team decision. Finally, since the university was a State university and the personnel were not part of a union, this WIU protocol of team selection was applied to all staff employed at the Center.

The health educators worked outside their offices and traveled to various locations around the State of Idaho. One of the first health educators that had been hired commented, "I like working with them (the healthcare providers) at their workplace. I can see them in their environment and gain a better understanding of what continuing education efforts they may need." Thus, the educators knew the job required travel, and they had been assigned cell phones and laptop computers to accommodate this situation.

Further, protocol developed by the Dean and Baldwin made all employees' hiring conditional, based upon their passing the Idaho Criminal Background Check. Applicants were fingerprinted and they completed a self disclosure arrest record questionnaire. The Background Check reported on felony and serious misdemeanor arrests in Idaho. Minor misdemeanors, local code violations and traffic violations were not recorded on the criminal record and thus, were not information yielded from the check. To date, the passing of the criminal background check had not been a major issue that had blocked applicants from being hired. Only one applicant had been found to have been arrested for a felony, and this applicant would not have been hired anyway because she had been determined not to have been a good fit with the Center by the hiring team.

The Department of Public Safety at WIU had also established policies regarding the use of state vehicles. Each health educator who drove an Idaho State vehicle had to pass a drivers' license check that reviewed their driving records for the last five years. To date, all hired educators had been approved to drive these vehicles.

The Training of Center Staff

Once hired, Center staff members attended HR directed training sessions that focused on WIU and Idaho State policies and procedures regarding employee rights. The training was conducted on the university campus over a two-day period. All health educators attended.

During day one of the training, facilitators presented University policies and procedures. The HR department representative oversaw the training regarding American with Disabilities Act (ADA), Sexual Harassment policy, and Affirmative Action. The discussion leaders were from the ADA

office, the University Women's Center, and the Office of Affirmative Action. The health educators received a copy of The WIU Faculty/Staff Handbook. This documentation contained information about ADA, sexual harassment, and affirmative action policies. Additionally, the handbook contained information about personnel policies concerning internal reviews that may result in suspension, dismissal, termination, and demotion of Center Staff (identified as Nonclassified Employees). See Appendix A for the university policy of internal review.

The University did not have a policy regarding the use of university owned cell phones or computers. Nonetheless, the HR representative had reviewed briefly two court cases that addressed an employee's right to privacy and the employer's right to monitor when he had discussed the University's Sexual Harassment policy. The first case referred to the degree to which an employee can keep materials in his or her work environment private. In *O'Connor v. Ortega* (480 U.S. 709, 720, 94 L.Ed.2d. 714, 725, 107 S.Ct 1492, 1987), a state-employed physician's desk and file cabinet had been searched by the employer. The Court ruled that the physician had a reasonable expectation of privacy regarding the desk and file cabinet. Thus, an employee does have some legitimate expectations regarding limited privacy in the workplace. The second case addressed a company's right to monitor employee use of company-owned equipment and search. In *United States v. Thorn*, F.3d (8th Cir. 2004), the court ruled that a search of a Missouri state employee's work computer was justified because there was a suspicion of illegal activity.

During this two day training period, Baldwin also facilitated a session regarding the use of cell phones. She explained that the staff members were responsible for reasonable treatment of the phones; she mentioned that all cell phone calls were documented in the monthly billing. Consequently, health educators knew from the training that their calls could be reviewed. It simply had not occurred to Baldwin to discuss with the staff not to use university computers for pornographic activity.

The final session for the first training day concerned travel in University vehicles. The Public Safety Department had a set policy for the use of such vehicles and a representative from Public Safety led the discussion regarding the policy. Only university employees could drive them; they were not allowed to use the cars for personal errands; and they could only have passengers who were associated with the work-related travel.

Day two of the training focused on professional development. When the health educators traveled, they were representing WIU. Hence, their behavior was a reflection upon the Center and the University. Moreover, professional behavior was key for job effectiveness. To enhance their professionalism, Baldwin designed the training to address emotional intelligence, communication skills, and professional presentation of self. To this end, she arranged for guest speakers from the Department of Counseling to serve as the discussion leaders. The trainers emphasized the importance of professional conduct, and the health educators participated in role-playing exercises that illustrated appropriate professional behavior.

Healthcare Educators and Their Allocated University Equipment

Each Center employee had an assigned work cell phone and laptop computer. The equipment was purchased via university contract with vendors, and the cell phones allocated were identical to one another. It was not uncommon for one health educator to pick up another health educator's phone by mistake. So, each staff member had personalized his or her phone in different colored cases to help curb the accidental trading of phones. The laptops and laptop carry cases were also identical. Occasionally, health educators accidentally took one another's laptop, but the mistake was discovered as soon as they turned on the computer and saw files that did not belong to them. Accidentally viewing someone else's computer had not been identified as a problem nor had any staff member complained if his or her laptop had been used by another staff member. Some educators had personalized their laptop cases with brightly colored tags to identify their laptops, but the computers themselves had not been personalized.

It is a Friday Afternoon . . .

Baldwin stopped pacing and faced the file cabinet in her office. She opened the bottom file drawer and removed a file labeled "Health Educator Training Session—WIU Personnel Policies." She returned to her desk, picked up a pen and underlined a few sentences (See Appendix A for the policy and the sentences she underlined.) She then picked up her phone. Whom to call first? What should she do to address this situation? Baldwin was concerned and knew she needed to act quickly, yet effectively.

Appendix A: WIU Personnel Policies

Faculty/Staff Handbook: Performance/Evaluation/Termination

Suspension, Dismissal, Termination, and Demotion of Nonclassified Employees (Updated 5/02)

1. General

Termination of an employee before the expiration of the stated period of his or her appointment or of a faculty member who has been granted tenure, except by resignation, or by retirement for age, will be only for "adequate cause." Any employee may be laid off in conjunction with a reduction in force approved by the Board and resulting from a declaration of financial exigency. Layoff and reinstatement of employees to duty will be as provided in the Board's rules regarding reduction in force.

2. Definition

"Adequate cause" means one or more acts or omissions which, singly or in the aggregate, have directly and substantially affected or impaired an employee's performance of his or her professional or assigned duties or the interests of the Board. In addition, any conduct seriously prejudicial to the University may constitute adequate cause for discipline up to and including dismissal or termination of an employee. Examples include, but are not limited to, one (1) or more instances of sexual harassment or other form of harassment prohibited by law; immorality; criminality; dishonesty; unprofessional conduct; actions in violation of policies, directives, or orders of the University or the Board; unsatisfactory or less than adequate performance of his or her assigned or contractual duties, or failure to perform his or her assigned or contractual duties.

3. Administrative Leave

The President may place an employee on administrative leave with pay until he or she has exercised the opportunity to respond, or has declined, either affirmatively or through inaction, to do so, and a notice of contemplated action has been acted upon by the President or his designee.

4. Interference With Conduct of Institutions of Higher Learning

Violations of Sections 33-3715 and 33-3716, Idaho Code, or violation of any law which results in a felony conviction of an employee may be cause for suspension with pay or dismissal from employment. It is not necessary that such violations be committed on the University campus or on the campus of one of the universities of the State of Idaho unless the same is a material element of such violation.

5. Procedure for Termination, Dismissal, Suspension and Demotion

a. Recommendation

Prior to any recommendation to the President of dismissal, termination, suspension, or demotion by a dean or department chair, supervisor, or other person responsible for making such recommendations, the employee must be given notice of the reasons for the proposed action, the evidence supporting the recommendation, and an opportunity to meet with the person making the recommendation to present any reasons, evidence, or information in mitigation or opposition to the recommendation.

b. Notification

If a recommendation of dismissal, termination, suspension, or demotion is made to the President, the President must notify the employee, in writing, of the recommendation in the following manner:

- (1) The President must notify the employee of the recommendation.
- (2) The notice from the President must be in writing and may be personally served upon said employee, or be sent by certified mail, return receipt requested, to the last known address of the employee.
- (3) The notice must contain a concise statement of the charges against the employee and the nature of the proposed action.
- (4) The notice must contain a statement of the employee's right to exercise the applicable University grievance procedures as set forth herein. Except as otherwise provided in these or Board policies, discipline, up to and including dismissal, may be effective prior to the initiation by the employee of the internal grievance process.

c. President's Decision

After receipt of the recommendations of the designated grievance committee, (see Part 4., Section V), the President or his appointee, will review the committee's recommendations and the record, and will issue a final decision in writing to the employee.

d. Appeal to the Board

The employee may elect to petition the Board to review the final decision of the President. A written petition must be filed in the Office of the State Board of Education within fifteen (15) calendar days after the employee receives written notice of the President's final decision. The Board may agree to review the final action, setting out whatever procedure and conditions for review it deems appropriate, or it may choose not to review the final decision. The fact that a written petition is filed does not stay the effectiveness of the final decision nor does it grant a

petition for review unless specifically provided by the Board. Board review is not a matter of right. An employee need not petition the Board for review in order to have exhausted administrative remedies for purposes of judicial review.

If the Board chooses to hear an appeal, it may, by a majority vote of the total membership, approve, reject, or amend the President's findings and decision, or may remand the matter for additional evidence, recommendations, or suggestions, if any. Reasons for approval, rejection, or amendment of such findings and decision will be stated in writing and communicated to the employee. The Board may employ a hearing officer for carrying out its duties regarding the appeal.

e. Board Initiated Discipline

If, under extraordinary circumstances, the Board itself initiates discipline, up to and including dismissal, against an employee, it must, by a majority vote, direct the President, or any other administrator as may be appropriate, to follow established procedures for discipline of the employee.

f. Internal Grievance Procedures

(1) Notification

Should the employee elect to use the internal grievance procedure to contest the proposed action, he/she must notify the Director of Human Resources by submitting a Nonclassified Employee Grievance Report, with a copy to the President within fifteen (15) days of receipt of the notice given by the President.

(2) Nonclassified (Nonfaculty)

Nonclassified (nonfaculty) employees shall use the Grievance Procedures for nonclassified (nonfaculty) employees.

SCR**THE SOCIETY FOR
CASE RESEARCH****PROFIT OR PRODUCT SAFETY: AN ETHICAL SHOWDOWN****Stacy M. Vollmers, University of Wisconsin, River Falls
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This case was prepared by the authors and is intended to be used as a basis for class discussion. All individual names, company names, and financial data are disguised. The views represented here are those of the case authors and do not necessarily reflect the views of the Society for Case Research. The authors' views are based on their professional judgment.

With tears in her eyes, Sally stared at their financial statements and admitted to her husband Peter, "I'm scared." Since founding their company, Quality Installations, they had focused on providing safe, high quality products and installations to insure their inclined elevators did not kill or injure someone. Sally had said, "I will never risk someone's life. I will close our company first."

However, as the year-end approached for 2008, their annual sales were down nearly 50% for the past two years. In addition, the year would end with the company in the red. They knew the housing crisis and other economic factors in 2007 and 2008 had contributed to the sales decline. In addition, they also believed that their commitment to the highest safety standards allowed competitors to underprice them. They also believed they were losing sales to competitors selling products and installations that potentially jeopardized customer safety.

Peter and Sally felt they faced a dilemma: Reduce operating costs and increase competitiveness by lowering the quality and safety of their products or maintain high standards and risk losing the business.

Quality Installations

Quality Installations make and installed inclined elevators (hillside elevators) in the United States. Sally and Peter Johnson started the company in 1990 as a seasonal operation, and by 1997, it had become a year-round business. Sally directed sales and marketing, while Peter directed operations and installations.

From 2002 through 2006, sales grew over 30% annually, reaching \$9 million in 2006. But instead of the continued growth they had expected, sales declined in 2007 and 2008. Fiscal 2008 had ended with total sales of \$5.5 million. At the end of 2008, Peter estimated that Quality Installations had sold 20% of the 400 units sold by the industry. Further, based on sales volume, he thought his firm was probably the second largest in the industry.

The Johnsons realized that the poor housing market and the economic recession of 2007 and 2008 contributed to their sales decline. Further, they knew they had always lost some sales because their products and services were priced higher than those of the competition. Nevertheless, a review of the company's lost sales list had disclosed that the percentage of sales lost due to price had increased significantly over the past two years.

Peter explained that not all of Quality Installations competitors "had the same focus on safety." When observing competitors' installations, Peter frequently saw potential safety problems that he believed could kill or seriously injure someone. It now appeared that the economic conditions were making customers even more price sensitive and more inclined to disregard safety and quality when making purchasing decisions.

Safety, the Johnsons recognized, was a vague and elusive concept. While they had always focused on safety, several years earlier Peter and Sally had struggled to establish their company safety standards. Eventually, they realized they could not set the industry standards so decided their company's policy would be to meet the standards of California (and Michigan, and Washington) which are the highest in the industry. They had observed that for many issues, California standards tended to become the United States standards over time.

The Inclined Elevator Market

The panoramic views afforded by bluffs, hillsides, and mountainsides provide coveted settings for homes. However, the hill providing the view frequently makes the site inaccessible, which created a niche market for "inclined elevators." Inclined elevators are installed outdoors and involve cables moving a tram up and down a hillside on rails (see Figure 1). The industry serves primarily home and vacation-home owners, in addition to a small commercial market.

Installation examples include the following: (1) A vacation home built on the water's edge below a bluff with highway access only to the top of the bluff; (2) A vacation home built at the top of a hill needing access to a lake below; and (3), a home in a very hilly community such as San Francisco.

Property inaccessibility was historically dealt with in two ways, neither of which was optimal. Properties were either considered inaccessible and not developed, or stairs provided access on the property. However, the length and steep slope on which stairs were built made climbing them difficult for many people. Inclined elevators solved this problem. Many of the people that can afford a luxury home with a fantastic view are older, or have small grandchildren, making

the prospect of climbing long flights of steep, narrow stairs several times a day unattractive, if not downright unsafe. An inclined elevator was a solution.

Inclined elevator systems are extremely expensive, starting at \$20,000, and exceeding \$500,000 depending on the site and installation. A typical installation might cost \$75,000 or more.

It appeared to the Johnsons that the inclined elevator market exhibited several segmentation criteria.

- 1) States with high safety standards and rigorous inspections, such as California and Washington versus states with less stringent safety standards and inspection.
- 2) Compared to inland installations, ocean installations had to withstand the extremely abrasive nature of saltwater requiring more expensive materials.
- 3) Demographic factors included higher incomes, higher wealth, and older people.
- 4) Consumers appeared to be price versus quality sensitive.

Product Description

Inclined elevators are outdoor equipment and involve a tram moving up and down a hillside on rails. Electric motors mounted at the hill top or bottom use cables to move the tram. Lengths vary from less than 50 feet to many hundreds of feet; they generally carry 500 to 1,000 pounds, and can be used on slopes that are almost vertical. Since every hillside varies in soil texture (from rock to sand), vegetation (from barren to heavily forested), slope (from modest to almost vertical), each installation requires a unique design for both the rail system and the installation process.

However, equipment that moves people up and down a very long, almost vertical slope involves significant safety concerns and issues. The rails must be permanently and solidly fastened into the ground. The tram cannot leave the track under any circumstances. Gravity acceleration of the tram car is not acceptable, meaning a relatively slow speed must be maintained. Every system must have emergency and backup systems. For example, if the cable breaks, the elevator must stop rather than careen down the hillside. Weather cannot affect the electrical or mechanical operations.

Regulation

At the national level, the 2004 National Incline Elevator Codes A.17, 5.1 and 5.4, regulate the industry. Regulations include three aspects 1) design, 2) installations, and 3) ongoing inspections of operating elevators.

At the state level, the specific agency responsible for inspecting elevators varied between states. Further, some states even used private sector inspectors. Lastly, each state implemented these

safety codes differently for inclined elevators. The West Coast and Michigan have implemented codes very stringently, while other states are more lax.

Generally, indoor elevator inspectors are also responsible for outdoor inclined elevators. However, because of limited industry sales compared to traditional indoor elevators, most regulatory agency personnel are infrequently involved with inclined elevators. Therefore, inspectors are not always familiar with outdoor systems or the safety issues they may present. Most importantly, the difference in ownership between indoor and outdoor elevators impacted both inspection and accident reporting. Hillside elevators are generally owned and used privately and thus, are not subject to the same ongoing inspections as elevators in commercial or public buildings. For example, an elevator accident in a public building is reported, while an accident on a private elevator is not. As a result, the reports of serious injuries caused by inclined elevators often resulted from lawsuits rather than news reports.

To protect consumers, Quality Installations had aggressively approached state governments for increased and uniform industry safety standards. However, the lobbying costs were extremely high and the company had experienced little success. Further, Quality Installations were surprised to find that the agencies responsible for inspection generally were not supportive of increased regulation because they were already overworked and underfunded.

Competition

Industry annual sales were estimated to be about 400 units annually for this relatively young industry (the oldest firms are less than 20 years old).

Further, there are few barriers to entry, and thus, there is much entry and exit. The new firms believe they can make a better product by looking at the competition and incorporating the best features of each into their own product design. The continual exit of inclined elevator companies left many customers with systems that no company would serve or repair. Potential liability and complicated proprietary technology discouraged firms from working on competitors products. Four firms had entered the industry during the past seven years, replacing five that had exited.

There were 10 firms competing in the inclined elevator market within North America, eight of which were based in the United States. The strategic groups based on geographic markets served are identified in Table 1.

Table 1: Competitive environment of the inclined elevator industry		
Marketing strategy	Firms ¹	Est. mkt share
The market leaders included four firms that competed nationwide by serving all, or most the U.S. market.	Quality Installations	75%
	Moving Bluff	
	Lake Side Transportation	
	Handy Access	
The West Coast market has substantially higher safety and environmental regulations. Two firms specialize in serving this market.	Brook Mechanisms	5%
	Hill Top Transport	
Two firms have recently entered the industry. These small firms do not yet serve multiple states.	US Tram Transport	10%
	JKO, Inc	
Canadian firms that sell only in Canada	Maple Leaf Elevators	10%
	Hill Top Elevators	
Some welding shops occasionally make a lift for one or two customer as a sideline business.	Welding shops	NS

Source: Peter Johnson

Potential Safety and Quality Issues

Quality Installation had lost \$75,000 bids to competitors that had bid as much as \$15,000 less. Peter believed part of the \$15,000 difference was due to lower quality product and installation standards, which could compromise safety and durability of an installation. He believed that from a safety standpoint, the 10-firm inclined elevator industry consisted of three strategic groups (see Table 2).

Table 2: Strategic groups based on safety-focus		
Strategic groups	Number of firms	Market share
Highly safety focused with a high quality product—Quality Installation was in this group.	3	40 percent
Too new or small to judge, but most new companies focused on making relatively high quality and safe products—due to inexperience, they probably did not achieve the same level of safety and quality as the first strategic group.	4	
Price focused—in Peter's opinion, these firms compromised safety by using some of the tactics identified below to cut costs and reduce prices to the final purchaser.	3	60 percent

Source: Peter Johnson

Sally and Peter knew that Quality Installations was in the first strategic group because of feedback. One potential Wisconsin customer called every company to gather information. Two firms that did not sell in Wisconsin strongly recommended only Quality Installations because of their quality and safety standards.

They observed that 60 percent of customers purchased primarily on the basis of price, while 40 percent purchased primarily on the basis of product quality and safety. Yet seven of the ten firms in the industry were fighting over the smaller market, including Quality Installations. This was also the market segment targeted by several new firms. Three of the seven firms focusing on quality and safety were new entrances during the past seven years.

Peter and his installation crews frequently saw competitor's products and installations. Following are some of the cost reduction strategies they observed:

1. **Avoidance of Insurance Premiums**—Some competitors changed names regularly. It appeared they might be closing one business and starting another. This reduced their product liability insurance premiums--which are very hefty in this industry--because they no longer pay premiums for past installations. Premiums are determined by current and past sales. When closing one business and opening another, firms can claim that they have insurance to new customers while their past installations are not covered. When the strategy is repeated in a few years, current sales will no longer be covered by product liability insurance. Consequently, homeowners have no legal protection from design or installation failures. Sally and Peter strongly disapprove of this practice. As a result, Quality Installations paid \$12,000 monthly for insurance that covered every elevator the company had or would ever install.
2. **Installing Without Licenses**—Not all competitors secured the licenses required to sell and install lifts in compliance with state law. Michigan, California, and some other states required a license to sell and install inclined elevators within their states. However, Peter had observed several instances in which competitors actually made a sale, and installed an elevator without obtaining the appropriate license. If caught, the homeowner--not the manufacturer--was forced to remove the elevator. While the homeowner might sue the manufacturer, the company often had insufficient assets to cover losses. To avoid this problem, Quality Installations had invested hundreds of thousands of dollars in getting licensed and was licensed in every state it served. Peter heard from one customer that a competitor was responding to questions about quality saying that, "they had just installed a system in California". While this was true, the competitor was not licensed in California and had done an illegal installation. While the salesperson's statement was true, it was certainly intended to mislead!

3. **Using Labor Lacking in Skill and Expertise**—Competitors occasionally cut costs by employing installation laborers with insufficient skill and expertise. Installing an elevator on the side of a mountain with an 80 degree slope in soil with varying holding capabilities required three factors: A thorough knowledge of the specific site, mechanical skill, and knowledge of the equipment and installation process. Some firms used local subcontracting crews to save travel and per diem expenses when they performed installations outside of their area. Sometimes these inexperienced crews did not even do a detailed site plan. In contrast, Quality Installations had experienced installers evaluate each site before manufacturing the inclined elevator. Based on their findings, they developed a site plan. Installations were completed by crews that included several experienced installers.
4. **Skimping on Materials**—Competitors occasionally alter the quality and quantity of material required. The safety of the rail system serving the tram depends on the depth of footings, the amount of concrete used in footings, and the quality of steel. There are two ways to reduce costs. First, an installer could cheat homeowners by using less material than specified in plans because customers could not see below the ground and therefore, could not check the depth or volume of the concrete. Second, installation specifications could call for footings that are too shallow; most customers would not understand the implications (less structural stability, possibly leading to collapse). Both practices reduce the safety of the lift system. Quality Installations invested in the design and amount of materials to insure their inclined elevators would give many years of reliable and safe service. Some competitors matched their installation quality, but others did not.
5. **Inadequacy of Engineering and Systems Design**—In addition to the amount and quality of materials used, engineering and system design, as well as the number of safety features seriously impact the cost and long term safety of an inclined elevator system. While every competitor claimed they offered a safe system, there were significant structural and design difference between brands.

Quality Installations had the largest engineering staff in the industry. They were licensed in all states that required licenses. In contrast, some competitors did not even attempt to seek a license in the states having the most stringent design regulations.

The Economics of Safety

Quality Installation knew their costs, but could only estimate competitor's costs. However, the difference appeared substantial (see Table 3).

Table 3: Estimated difference in costs between low cost firms and Quality Installation for the five safety factors.

Issue	Estimated cost for low cost firm	Quality Installation's cost	Difference
Insurance	\$1,500	\$3,000	\$1,500
License	\$500	\$2,500	\$2,000
Installation labor and costs	\$3,500	\$6,500	\$3,000
Materials	\$22,000	\$24,000	\$2,000
Engineering and design capability	\$500	\$5,000	\$4,500

Source: Peter Johnson

The Decision

Sally and Peter Johnson sat and discussed their options. They knew that customers could easily evaluate price, but not the quality, design, and safety of the inclined tram or rail system. As a result, customers didn't know what to look for in an inclined elevator system and tended to rely on the salesperson's word. As they brainstormed possible solutions to their problem, they discussed the pros and cons of the following options:

- Continue to seek higher government regulation of the industry
- Form an industry trade association that set industry safety standards
- Lower safety and quality standards
 - Find a way to lower price without impacting quality
- Create customer preference for their product through promotion activities and education about product differences.

Peter and Sally weren't sure that an ideal option existed. But they knew they needed to take action.



Figure 1: Inclined elevator in operation
(Source: Quality Installation)

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**THE SOCIETY FOR
CASE RESEARCH**

REASONABLE ACCOMMODATION?

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This critical incident was prepared by the authors. The views presented here are those of the case authors and do not necessarily reflect the views of the Society for Case Research. The authors' views are based on their professional judgments.

Janet Daugherty was in an uncomfortable situation as she testified in court for her employer, a local Wal-Mart store. As Personnel Manager of the store, she was deeply involved in a lawsuit brought by the Equal Employment Opportunity Commission (EEOC) alleging that her store had violated the Americans with Disabilities Act (ADA). The EEOC specifically contended that Wal-Mart improperly refused to hire Steven Bradley because of mobility limitations caused by his cerebral palsy (see www.eeoc.gov/types/ada.html). Janet must now defend her position.

Background Information

Bradley's cerebral palsy limited the use of his legs, forcing him to use forearm crutches for short-distance walks and a wheelchair for longer distances. Standing for more than 10 to 15 minutes was also difficult. With support, however, Bradley could walk, climb stairs, and get on and off of a stool-albeit slowly. His condition also restricted his third and fourth fingers, as they generally worked as a unit and precluded him from using his fourth finger, for example, when typing. His limited hand dexterity, however, did not limit his ability to write, hold things, or complete "daily living" tasks, such as carrying laundry or groceries or doing his own housekeeping. Bradley's grip strength was normal, and his arm strength allowed him to lift heavy objects even from his wheelchair.

In July, Bradley applied for a "Greeter/Customer Assistant" position at a local Wal-Mart and in February, he applied for a Cashier position at another neighboring Wal-Mart. The job descriptions for both positions indicated numerous aspects of the jobs that required mobility and

standing but also indicated that no experience or qualification was required. Ultimately, Wal-Mart did not hire Bradley for either position.

Wal-Mart's Actions Challenged

When asked why Wal-Mart did not hire Bradley after his February application, Janet initially testified that Bradley was not hired for the position based on "a lot of factors." She stated that the "main reason" that Bradley was not hired was because of his job history, as she was personally aware of short-term jobs that Bradley had held in their "small town" that he failed to list on his application. Those "short-term jobs" included Bradley working at a Texaco service station, at Shirkey Leisure Acres, at Station Casino, and as a police dispatcher. When later asked whether she had specific information showing that Bradley had definitely worked at Texaco, Shirkey, Station Casino, and as a police dispatcher at the time she made the decision not to hire him, she responded, "I'm not-I don't know." She said that she personally saw Bradley working at Texaco; however, she eventually admitted that she was "not sure if in all honesty if he worked at Texaco *before or after* the application." (Emphasis added). She also admitted that she was unsure whether Bradley worked at Shirkey or Station Casino *before or after* she decided not to hire him.

In fact, Bradley, *never* worked at Station Casino; he only attended a six-week training course there. In addition, he started working at Shirkey in June, *after* Wal-Mart rejected his application. Likewise, he began working for the Richmond Police Department as a police dispatcher in August, *after* Wal-Mart rejected his application. Finally, Bradley only worked at Texaco for one day.

Both Wal-Mart and the EEOC had differing opinions on the issue of reasonable accommodation for Steven Bradley. In support of their positions, each relied on the testimony of expert witnesses.

Wal-Mart's Position

Wal-Mart argued that the EEOC could not prove that Bradley was qualified for any available position, including the greeter and cashier positions and was therefore justified in denying employment. In support of its position, Wal-Mart relied on the expert testimony of Dr. Chris Fevurly. Based on an independent medical examination of Bradley, Dr. Fevurly stated that, in his opinion, Bradley was not qualified to perform the essential functions of either job. Dr. Fevurly concluded that Bradley (1) could not carry or move objects that required two hands, as he must use one arm at all times to support his weight while standing and both arms to walk with his crutches; (2) could not operate a "push mower," meaning that he could not operate a "push/pull" device as Kent Jayne (EEOC expert) suggested; (3) must use his crutches to climb on and off stools and takes considerable time transitioning from a sitting to a standing position; (4) falls every other week in a controlled environment using his crutches, and his chances of falling would be "daily" in a retail environment; (5) could not perform prolonged walking and standing,

as required by the positions; (6) could not perform squatting or crawling and could only kneel for five minutes or less; (7) could only perform occasional bending and stooping; and (8) had not attempted to perform 8-hour shifts or 40-hour work weeks.

In addition, Wal-Mart argued that Bradley would be a direct threat to himself and others. Wal-Mart's expert, Dr. Fevurly, opined that Bradley would pose many safety risks if he was hired as a greeter or cashier. Specifically, Dr. Fevurly testified that the "biggest risk is the fact that [Bradley's] legs are not capable of holding him without arm support," as Bradley admitted that he frequently falls on floors that have impediments. Second, Dr. Fevurly pointed out that Bradley was "very wide when he uses his crutches ... twice the width of a normal person depending on the area where he is," meaning that Bradley could pose an "obstacle" to people coming in and out of the store. Finally, Dr. Fevurly stated that standing for an entire shift would "place [Bradley] at great risk" for "recurrent back and knee pain" that would "make it difficult to tolerate these tasks" over time.

The EEOC's Position

In response, the EEOC's main expert, Vocational Rehabilitation Consultant Kent Jayne, concluded that Bradley, with reasonable accommodation, could work as a cashier or greeter and would not pose a "direct threat" in either job. Because the job descriptions for both jobs required "some mobility and standing," Jayne recommended a sit-to-stand wheelchair, an ergonomic drafting-type stool with armrests, a scooter stool, or a lightweight wheelchair as a reasonable accommodation.

For the greeter job, Jayne thought that Bradley would not need an accommodation to verify payment with a hand scanner or to move shopping carts or empty trash baskets, although he might do the latter two tasks more efficiently with an electric scooter or similar device. For the cashier job, Jayne recommended a sit-to-stand wheelchair, which would enable Bradley to be upright and reach out horizontally; a drafting-type high stool with armrests for additional balance, if needed; a wheelchair narrow enough to fit into the check stand area; removing several inches of the divider to the right of the check stand to accommodate a regular or electric wheelchair; supplying Bradley with a hand scanner to scan prices on large objects; and installing a convex mirror to enable him to spot items under shopping carts. He suggested that, if Bradley used a wheelchair or electric scooter, he "would pose no greater danger than any customer in a wheelchair or electric scooter, both of which Wal-Mart provides to customers for use in their stores." Dr. Daljeet Singh, Bradley's treating physician, also testified that Bradley was in good health and could safely do the tasks involved in the greeter and cashier positions.

Wal-Mart's Response

Dr. Fevurly, questioned whether Bradley could safely balance while seated on the drafting-type stool that did not have armrests. He acknowledged, however, that there would be a decreased risk

if Bradley used a wheelchair, conceding that Bradley is “very ... stable in a wheelchair.” He also stated that he did not have a “huge problem” with Bradley using a motorized scooter or similar device, as long as he was careful. He concluded, however, that based on his observation, Bradley would “have to be up on his feet” as a cashier and, while he could sometimes use a wheelchair as a greeter, he would still have to “get up and do tasks where he is standing probably somewhere between 35 and 40 percent of the time.” But, he did admit that Bradley would need to bend over and pick up items only infrequently and that, using his wheelchair, Bradley could lift and carry heavy objects “in a nearly unlimited fashion.”

In addition, Wal-Mart attacked the *method* by which the EEOC’s expert witness proposed these accommodations, pointing out that he had never personally observed Bradley use these devices or perform the duties that would be required of him as a greeter or cashier. Janet wondered what the final ruling would be. Would Wal-Mart be forced to hire Bradley for one or both of the positions for which he applied? If he were hired, what types of accommodations might be required for him to perform the essential functions of the positions in question?

Based on E.E.O.C. v. Wal-Mart Stores, Inc., 2007 WL 447941 (8th Cir.).

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**THE SOCIETY FOR
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REFCO: OUTWITTING THE AUDITORS

Gabriele Lingenfelter, Christopher Newport University**Jennifer L. Barger Johnson, University of Central Oklahoma**

This critical incident was prepared by the authors, and is intended to be used as a basis for class discussion. The views represented here are those of the critical incident authors and do not necessarily reflect the views of the Society for Case Research. Authors' views are based on their own professional judgment.

Joe Defraud finished his breakfast. Joe had been with Grant Thornton for 15 years and was the lead auditor on the Refco engagement. He had just talked to Grant Thornton's legal counsel and had learned that a class action suit had been filed against the CPA firm regarding its involvement with Refco. Concerned about the repercussions to his career, he nervously opened the newspaper. While wondering if the audit team had missed "red flags" pointing to the fraud, he read the feature article in the financial section.

From IPO to Bankruptcy in Nine Weeks

On October 10, 2005 Refco, Inc. announced that an entity controlled by its Chief Executive Officer, Phillip R. Bennett, owed \$430 million to Refco. This amount was listed in Refco's financial statements, but was not disclosed as a related party transaction. Refco immediately announced that the public could no longer rely upon its financial statements for 2002 through 2005.

Just two months earlier, Bennett, himself, rang the opening bell at the New York Stock Exchange to celebrate Refco's first day of public trading. By the end of this first day, the value of Refco's stock had increased by an impressive 25%. Now the stock's value dropped as rapidly as it had previously grown. Many of Refco's clients immediately liquidated their accounts, further depleting Refco's assets and resulting in the fourth largest bankruptcy filing in the United States.

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Refco's independent auditor, Grant Thornton, had issued an unqualified opinion on the financial statements filed with the registration statement. While internal control deficiencies were identified, Grant Thornton did not discover undisclosed related party transactions. Were there any risk factors or signs that should have alerted the auditor to a violation of Generally Accepted Accounting Principles (GAAP)?

Company Background

Refco Inc. (RFX) was incorporated in Delaware with its principal executive offices in New York City. The company provided financial services to customers, primarily brokering commodities, and futures contracts. Founded in 1969 as "Ray E. Friedman and Co., Refco eventually expanded to 23 locations in 14 countries, served over 200,000 customer accounts and became the largest broker on the Chicago Mercantile Exchange in 2004. Revenue was earned from transactions with customers and from interest on cash balances in customer accounts.

In August 2004 the private equity firm Thomas H. Lee Partners acquired a 57% interest in Refco. Refco's management retained a significant ownership interest. Thomas Lee, a 1965 graduate of Harvard College and founder of Lee Partners, stated that the ultimate goal was to take Refco public. Praising Refco's management team, Lee noted: "We're a company that likes to invest in businesses that have strong growth opportunities and outstanding management teams, and this really has both." As Lee had predicted, Refco announced an initial public offering of 26 million shares at \$22 per share on August 11, 2005. Because of previous years' profit growth, investors eagerly purchased shares and by the end of the first day of trading the company's shares had gained 25%.

Participants to the IPO included CS First Boston, Goldman Sachs, and Banc of America Securities, as the principal underwriters, and the accounting firm, Grant Thornton, as the auditor of the financial statements filed with the prospectus and registration statement.

Management

Ray Friedman and his stepson, Thomas Dittmer founded "**Ray E. Friedman and Co.**" (Refco) in 1969. Friedman had grown up in Iowa, where his family was poor and made money by selling chickens and eggs. A few years later, the experience with his family's enterprise led the ambitious Friedman to establish the company "American Produce", through which he sold farm products to retailers and the United States Army. Success was short lived, however, and in 1952 Friedman was convicted for falsifying the meat stamps on chickens sent to army troops in Korea. Friedman was paroled in 1955 and shortly thereafter met and married Evelyn Levine, the mother of Thomas Dittmer.

As soon as the Chicago Mercantile Exchange began to trade in cattle futures, Dittmer and Friedman, opened Ray Friedman and Company in 1969. The company prospered despite the fact

that the two founders did not always play by the rules. Being fined numerous times by the U.S. Commodity Futures Trading Commission (CFTC) for keeping insufficient records and filing false trading reports, Friedman's, Dittmer's, and Refco's reputation became more and more tainted. Disagreements on how to reinvest revenues resulted in Dittmer buying out Friedman's share in Refco in 1974. However, Friedman continued trading through the company, and enjoyed a high society life style, while again being cited for CFTC violations. Dittmer and Refco, as well, got in trouble with the CFTC for record keeping violations, eventually causing Dittmer's resignation in 1999.

In 1981 Bennett was hired by Refco and was immediately hailed as the company's rescuer. The British-born Bennett had graduated from Cambridge University with a degree in geology, and had spent eleven years working in the commodity and commercial lending departments of Chase Manhattan Corporation. Immediately, Bennett set out to improve Refco's financial position and reputation, working long hours, rarely socializing and continuously monitoring the markets. His hard work paid off when he was named Refco's Chief Executive Officer in 1998. Through 2004 Refco's revenue grew by over 24% a year. Ultimately, Bennett became one of the wealthiest of Britain, owning a Penthouse on Park Avenue and a horse farm in New Jersey near Jacqueline Kennedy's estate.

The Auditors

Grant Thornton, LLP replaced Arthur Andersen as Refco's auditor in 2003. Grant Thornton LLP was one of the largest accounting firms after the big four, with over 50 offices in the United States. The company issued unqualified auditor's reports to be included in the registration statement filed with the SEC.

While Grant Thornton issued unqualified audit reports, the auditors warned Refco's management of internal control issues. The auditors identified several internal control deficiencies, including their opinion that Refco's accounting department was understaffed, which resulted in a severe problem with the timely reporting of financial results. No formalized closing procedures existed and the company was not in compliance with Securities and Exchange Commission (SEC)'s reporting guidelines. Refco's management and board of directors acknowledged the identified deficiencies in internal controls and included the following risk assessment statement in the registration statement filed with the SEC:

Figure # 1

Our auditors reported to us that, at February 28, 2005, there were two significant deficiencies in our internal controls over financial reporting.

In connection with their audit of our most recently audited financial statements, our independent auditors reported to us that we had two significant deficiencies in our internal controls over financial reporting. Under standards established by the Public Company Accounting Oversight Board, a “significant deficiency” is defined as a deficiency that results in more than a remote likelihood that a misstatement of the financial statements that is more than inconsequential will not be prevented or detected. One significant deficiency was determined to exist based on the need to increase our existing finance department resources to be able to prepare financial statements that are fully compliant with all SEC reporting guidelines on a timely basis. The second significant deficiency was determined to exist based on our lack of formalized procedures for closing our books. Currently we utilize the services of an outside service provider to assist in our financial reporting process. We are in the process of enhancing our financial reporting capability by hiring additional internal audit and finance personnel and developing formalized closing procedures, including through the implementation of software upgrades throughout our operations. Although these measures are designed to address the issues raised by our independent auditors, these and any future measures may not enable us to remedy these significant deficiencies or avoid other significant deficiencies in the future. In addition, these and any other significant deficiencies will need to be addressed as part of the evaluation of our internal controls over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act of 2002 and may impair our ability to comply with Section 404. See “—We will be exposed to risks relating to the evaluation of our internal controls over financial reporting as required by Section 404 of the Sarbanes-Oxley Act of 2002.” (FORM S-8 REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933 Refco Inc.)

The Scheme and an Astute Controller

In the early 1990s some of Refco’s customers suffered sizeable trading losses because of the financial crisis in Asia. As a result, large amounts of receivables became uncollectible. Refco Group Holdings (RGHI), an entity controlled by Bennett, assumed the bad debts of Refco to improve the financial position of the company and to eliminate the need for write offs. Eventually, the accounts receivable from RGHI grew to hundreds of millions of dollars. None of these transactions were disclosed by Refco as related party transactions in its SEC filings or audited financial statements.

In February 2000, prior to the end of Refco’s fiscal year, Bennett and RGHI devised a scheme to hide the fact that RGHI by that time owed hundreds of millions to Refco. Through a series of short-term loans, RGHI borrowed money from Bank fuer Arbeit und Wirtschaft (BAWAG), a major Austrian bank, making it possible for RGHI to temporarily pay off some of its debt to Refco. A few days after the Refco fiscal year-end, journal entries reversed the transaction, and RGHI again showed the debt owed to Refco. In a similar fashion, a Refco subsidiary lent money to Liberty Corner Capital Strategies, a New Jersey hedge fund, which in turn loaned the money

to RGHI. RGHI then ultimately completed the loop and paid the money to Refco. By shifting the uncollectible accounts between Bennett's private company, Liberty Corner, and BAWAG, Bennett was able to hide the \$430 million in debt owed to Refco. These intricate transactions between BAWAG, Liberty Corner, Refco, and RGHI allowed Bennett to conceal the true condition of Refco's balance sheet as they were repeated yearly through 2005.

Because of the complexity of the transactions, Bennett succeeded in deceiving the company's auditors. Bennett did not anticipate that his covert debt would be discovered by an employee from Refco's accounting department. Refco's newly hired controller, Peter James, became suspicious when he discovered an unusually large interest transaction paid to Refco on an outstanding loan. This transaction caused James to wonder about its origin, and he soon discovered that Bennett and Refco Group Holdings were actually responsible for the payment and related debt. James approached the chief financial officer, Gerald M. Sherer, regarding his findings. Immediately, Refco's audit committee started an internal investigation, and on October 6, 2005 the three-member audit committee, led by Ronald O'Kelley, CEO of Atlantic Coast Venture Investments Inc. in Naples, Florida, confronted Bennett, then announced the defalcations to the public.¹ On October 12, 2005, Bennett was arrested and charged with securities fraud, a mere two months after its initial public offering (IPO). Subsequently, Refco's stock fell from \$29 to 65 cents.

As Joe closed the paper, he trembled and wondered how his audit team could have missed the now obvious signs pointing to fraud. He realized that he now faced the "auditor's nightmare". How would he prove that the audit was performed with due diligence and according to auditing standards?

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SERUS: CONTINUE TO BOOTSTRAP OR SEEK VC FUNDING?

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This critical incident was prepared by the authors. The views presented here are those of the case authors and do not necessarily reflect the views of the Society for Case Research. The authors' views are based on their own professional judgments.

Introduction

It was 7pm on a warm and sunny Friday evening in Mountain View, California. Unaware of the glorious weather outdoors, Indu Navar and Barbara Hoefle were huddled together in the office, deep in discussion about the future of their company, which had reached a crucial crossroad. Indu reminisced about the early days of the business when they had focused on market validation, and when every sale was a huge achievement in reducing the burden on their personal finances. Now, there was a new challenge facing the company. Three years after founding Serus Corporation, the two women wondered whether or not to continue with their strategy of bootstrapping the company with some support from angel investors. Or was it time to approach venture capitalists (VCs) to help grow the company at a faster pace?

The two co-founders of Serus Corporation, a company providing supply chain management software solutions for global clients, had self-funded or 'bootstrapped' the initial stage of their start-up. They had used their experience to grow Serus with minimal external funding. Serus' sales revenues had grown steadily since start-up, as global companies continued to buy and install software applications to improve their transportation, warehousing, and distribution operations. However, Indu anticipated that sales revenues would soon reach a plateau unless the company accelerated its business development, marketing, and sales efforts. If the VCs invested, they could bring in millions of dollars into the company that could help to fund the development efforts, and attract new customers and employees. But Indu knew that this was not just about the money. If the VCs invested, she and Barbara would no longer have complete control over Serus.

Was it worth ceding control to grow the company? Involving VCs would also go against Indu's principles of self-funding her venture. Besides, would the company's growth prospects necessarily improve with VC funding? Some of their VC-backed competitors had already closed down. Would Serus end up the same way? These were some of the many questions that Indu asked herself. She knew she had to make a decision quickly. She wanted to build a strong company with a core ideology that was "built to last" (in the words of Jim Collins in his book with the same title) and that would make a lasting impact on the enterprise software industry.

The Founders

Born into a family of entrepreneurs who were technologists, Indu Navar, one of the two founders of Serus Corporation, always had a passion for finding solutions to complex problems. Just like her father, who was an entrepreneur and also her role model, she had always wanted to start her own company. After completing a Bachelor of Science degree in Electrical Engineering from Bangalore University in India, Indu came to the US to pursue a Masters degree in Computer Science at California State University, Chico, and went on to work at NASA, Silicon Graphics, and Healthon (WebMD). She was one of the initial team of engineers for WebMD, which was her first experience of working in a new venture.

In February 1999, Indu met Barbara Hoefle, who was then employed at UPS and had over 15 years of experience in the supply chain, logistics, and manufacturing market. Indu, who had recently quit her job at WebMD to explore new opportunities, approached Barbara with a business plan and the two women arranged to meet. Barbara was not impressed by the business plan, but at their meeting she "quickly assessed that Indu had all the qualities of being a successful entrepreneur...Indu came across as a brilliant technologist, who had a clear understanding of business problems and their challenges."

Thirty days later, Indu approached Barbara again to brainstorm some new business ideas. Indu felt she had found the right partner in Barbara, whose extensive supply chain experience and excellent customer skills complemented her own background in software. Nevertheless, she wanted to make sure they were both on the same page before they started. She was determined to 'bootstrap' her business, in other words, to use strategies "to minimize the amount of outside debt and equity financing needed from banks and investors" (Ebben and Johnsen, 2006, p.853). This was in line with her mantra of "find your customer first, not a venture capitalist". Indu asked Barbara if she was willing to work without salary for the first year. Barbara said yes. That marked the beginning of their partnership.

Company background

By 2000, top companies around the world had started shifting to supply chain management (SCM) software to improve distribution efficiency. The market for SCM software was estimated

to be around \$8.5 billion worldwide (Software Magazine 2001). US companies spent about \$3.8 billion on software for supply chain planning and execution in 1999 (Cooke 2000). In 2000, software sales were expected to reach \$5.3 billion, an increase of about 39 percent. The sales figures included revenues from software licenses, implementation, maintenance, and hardware purchases. Ranked by revenues, i2 Technologies was the market leader among SCM software vendors. The top ten vendors accounted for nearly half of all sales, as indicated in Table 1.

Table 1 <i>Top 10 SCM Software Vendors by revenue (\$ millions) and market share (%) in 1999</i>		
Top 10 SCM Vendors	Revenue	Market Share
I2 Technologies	\$571	14.60%
IBS	\$272	7.00%
SAP	\$201	5.15%
Manugistics	\$148	3.80%
EXE	\$97	2.49%
IMI	\$91	2.33%
Manhattan Associates	\$81	2.08%
J.D. Edwards	\$69	1.77%
McHugh	\$67	1.72%
iLOG	\$64	1.64%
Total Revenues of top 10 companies	\$1,661	42.58%
Total Supply Chain Software Market Rev (est.)	\$3,900	100%
Source: Cooke (2000) based on AMR Research rankings of 1999 revenues for software & professional services within SCM. MSI Magazine (2001) listed Oracle as a key player in the SCM market.		

According to AMR Research forecasts in 2000, the market for SCM systems would climb from \$3.8 billion in 1999 to \$20.3 billion in 2004, implying an average annual growth of 40 per cent (IBS Press Release, June 2000). Large companies like SAP and Oracle were important players in this market (MSI Magazine 2001), although SCM solutions were only a small part of the business of these billion dollar companies (SAP America had revenues of \$5.58 billion, and Oracle had total revenues of \$10.7 billion in 2000).

During the first half of 2000, Indu and Barbara perused market research reports prepared by Gartner, Forester, and other firms, and spoke with their friends and acquaintances in the field of SCM, to figure out exactly what companies using global SCM software were looking for. As Indu noted, “I knew there was a need for a global supply chain [management] solution for companies who had outsourced their manufacturing.” Through consulting projects, they gained access to the spreadsheets of companies using SCM software and decoded those spreadsheets to understand how they could better address the individual needs of those companies.

After spending six months interviewing around 50 companies and over 200 people at all level of operations from CEO to CFO to the planners, and doing their own research, Indu and Barbara realized that the big vendors of SCM solutions were not focusing on customized software

products for their customers. Customers were spending large sums of money on applications, but continued to encounter supply chain inefficiencies. Indu and Barbara saw this as an opportunity worth exploring and put in some initial money to research the market further. As Indu recalled:

What I found was that everyone...assumed that there will always be shortage of supply, so the competitors focused on providing solutions for 'how and where do I get my supply from, to meet my demand?' and there were no offerings really focused on lowering costs or improving efficiency in SCM, that is – 'How do I make and ship my products in the most efficient and cost effective way?' But the minute the 2001 downturn hit, customers started to invest in solutions to improve the efficiency of their supply chain. (Personal Interview, July 2005).

Indu attended numerous networking events. She became a member of The Indus Entrepreneurs (TiE), the largest global network of entrepreneurs started by Indian Americans in Silicon Valley. At the annual TiE conference ('TiECon') in May 2000, Indu discussed her start-up concept with Dr. Ronjon Nag, CEO and Co-Founder of Cellmania, a leading wireless applications company based in Mountain View, California. Dr. Nag was so impressed by Indu's entrepreneurial passion that he promised to give her \$100,000, once she had her first purchase order. Indu was thrilled to have found her first angel investor.

While working at headquarters, which at the time happened to be her kitchen table, Indu recalled that "we decided around August 2000 to come up with global web-based real-time SCM software that could be reused, easily upgraded and tailored to the changing needs and demands of the corporate customer". They began to build their first prototype. The next task was to find customers for their product, and be heard in a market that was already dominated by big vendors.

At a party in August 2000, Indu struck a casual conversation with one of the other guests. Their conversation led Indu to a project manager at Quantum Corporation, a global manufacturer of tape drive and storage products, and a prospective customer for Serus' software. Indu and Barbara eventually managed to meet with Quantum's senior executives and requested them to elaborate upon their SCM challenges. Within a span of four days after their extensive talks with Quantum executives, Indu and Barbara presented a solution that addressed Quantum's key concerns, such as inventory replenishment, monitoring and alerts, historical data capture, and company reporting requirements. They came up with the solution from the existing software that had been written by the Serus team. In November 2000, Quantum invited Serus, along with Fortune 500 companies such as IBM and Oracle, to bid for the contract for their SCM solution.

In less than six weeks, Indu, Barbara, and their team, integrated and customized Serus' solution for Quantum. In January 2001, Quantum signed a contract with Serus for \$250,000 to buy its SCM software to help manage inventory between trading partners. At this time, Serus was still operating from Indu's kitchen. After winning the contract, Indu approached Ronjon Nag with the

purchase order. As he had promised, Nag gave her a check for \$100,000. He also agreed to become an advisor to the new company. The funds helped Serus to move into their new office premises in Mountain View and hire additional employees.

The contract with Quantum gave Serus valuable publicity. As Mike Wais, Director, eSupply Chain group at Quantum stated, “the Serus application... is very slick with a user friendly look and feel. The information we need is at our fingertips and we can now automatically execute on key decisions, which saves us time”. At the time, Serus was the only “off the shelf” value chain solution that was customizable by the user. “In volatile markets, change is a constant,” said Indu. “We give our customers the ability to change business rules as needed and when they need to”.

By 2004, Serus had expanded from one large customer (in 2001) to 8 customers and from 5 to 19 employees. Indu realized that Serus was no longer strictly a ‘start-up’. The company had a small sales team and she was no longer responsible for every sale and for every customer issue. The founders appointed a Board of Directors to help structure the company’s product line and formulate a clear market strategy to penetrate the target market. Meanwhile, Indu’s brain was buzzing with questions. What was the best way of going about choosing their main vertical market? What criteria could they use to make this judgment? Deciding on the target market was only the first of many challenges.

Funding the next stage

Until now, Indu and Barbara had bootstrapped their company along with some help from angel investors like Dr. Nag, who invested \$100,000-200,000 and became advisors to the company. Should they continue to bootstrap it and rely on the support of their angel investors? Or was it time to seek a more substantial injection of funds via external venture capital (VC) finance? Indu and Barbara had spent more than three years of their lives building Serus from scratch, with their own money and ‘sweat’ equity. They were conscious of the fact that many of their competitors had raised “anywhere between \$10 million and \$110 million from VCs”.

By bootstrapping their start-up, both founders had borne financial risks, which they had consistently tried to minimize. They had hired the minimum number of employees necessary and furnished their offices by making purchases off Craigslist. They occupied the same office space despite growing revenues. While bootstrapping had forced them to be frugal, the absence of other significant stakeholders had given the founders the freedom to set their company’s direction. As Barbara reminisced, this desire to control their destiny was a key reason why she and Indu quit their jobs to found their own business. For Indu, one of the joys of being an entrepreneur was having the independence to pursue her mantra of focusing on the customer.

So far, Serus had survived using minimal external funding. Many successful companies, including Dell Computers and other *Inc. 500* businesses, were founded in this way. Serus could

continue to rely on angel investors who had supported its start-up. Both founders knew at least a few highly successful and seasoned entrepreneurs, who could be persuaded to invest between \$100,000 and \$200,000 in Serus and join its advisory board. Some of those entrepreneurs were interested in funding new ventures started by women and by members of the TiE community. Like institutional venture capitalists, many angel investors gave money to early-stage new ventures in exchange for a small equity stake in the company. Angel investors typically invested smaller sums of money in individual companies than institutional venture capitalists and took a longer-term view in realizing the returns on their investment. With angel funding and a continuation of the founders' austere practices, the company would likely grow steadily.

On the other hand, venture capitalists (VCs) could potentially invest millions of dollars into Serus. VC firms raised money from large institutional investors, like company pension funds and university endowments, and invested those funds in new ventures (Baron and Shane 2008). VCs were therefore obliged to share a percentage of the returns from their investments with their institutional investors. Thus, VCs had an active interest in realizing profits from their investments, usually, within 5 years. In addition to providing financial support to a start-up, VCs could help in identifying key customers, partners, suppliers, and employees, formulating company strategy, and determining its implementation. Indu was sure the VCs would want to help her decide what target market to focus on and provide the funds to enable Serus to hire more employees and build its sales and business development team. VC funding also had a certain glamour associated with it. After all, fast growth innovative 'tech stars' like Apple, eBay, and Google, were all funded by VCs. Could they have been so successful without VC support?

As Indu and Barbara were well aware, the extra injection of funds would probably help to speed up Serus' growth. But this decision wasn't just about the money. Wasn't it likely that they – Indu and Barbara – would lose control over the business they had launched with so much effort and passion? After all, Serus was their 'baby'. Their ownership in the company would necessarily decline with new investors. Were they ready to give up management control as well?

They had heard horror stories about the impact of introducing VCs into the business. Friends freely gave their advice: "once you involve VCs in the start-up, you remain at their mercy; they effectively become your boss". "VCs can really open doors for you with potential customers and partners...if your business does well, they may leave you alone. But if you start losing ground, they can be very demanding and give you hell. They could force you to close the business or ask you to step down as CEO or even quit the company". Barbara had heard that VCs employed 'forfeiture' and other legal provisions that caused entrepreneurs to lose ownership if their performance fell below target goals and could transfer ownership from the entrepreneurs to the investors if the venture failed to meet performance targets. Indu recalled reading a study that showed that in Silicon Valley, 10 per cent of CEOs of VC-backed young high-tech companies were replaced in the first 20 months.

Some of Serus' VC-backed competitors, such as Valdero, had already closed down. Would Serus end up the same way? Did it make sense for Indu to violate her own principles of self-funding her venture and focusing on the customer? The VCs' goals would surely be focused on short-term return on investment, compared with those of Indu and Barbara, who preferred longer-term survival. Instead of focusing on satisfying their customers, they would end up focusing their energies on trying to satisfy the VCs. They already had a couple of angel investors whom they could potentially tap for more funds. However, angel funding was also not "free" money and involved giving away at least a small equity stake in the company. Besides, individual angel investors seldom invested more than \$200,000 in a start-up. While it wasn't easy to secure angel funding, the individuals who had invested in Serus had done so because of their faith in the founders' entrepreneurial ability as much as in their business concept. The co-founders also considered the possibility of debt financing, but they did not yet have any tangible assets to assign as collateral to a bank to secure a long-term loan.

The VC world was completely new to Indu and Barbara. How would they choose the 'right' VC? How would they gain access to them? How would they persuade the VCs to invest in Serus? Indu recalled having heard that *Pratt's Guide to Venture Capital Sources* was the best tool for targeting VC prospects. Apparently, the *Guide* included a comprehensive list of over 1,700 VC firms and provided complete contact data as well as information about the size of the funds, recent investment history, and industry preferences. Indu dreaded having to review such a long list. Barbara remembered once seeing the *Insider's Guide to Venture Capital* that listed over 400 active VC firms. Someone mentioned the National Venture Capital Association's directory, which listed the most prestigious VC firms, but those were also the toughest to secure funding from. Indu and Barbara were aware that VCs never responded to cold calls from entrepreneurs. To save time knocking on the wrong doors, they would have to spend time tapping their social network to gain access to the VCs. That would be followed by more time invested in preparing their business plan and pitch to investors. It would involve immense persistence and a lot of hard work. Besides, everyone knew that the chances of securing VC funding were low, since VCs were known to invest in less than 5 per cent of the business plans presented to them. VCs also typically preferred experienced entrepreneurs who had prior experience of starting and growing a business, which neither Indu nor Barbara possessed. Was seeking VC funding really worth all the time and effort that they could otherwise devote to finding new customers?

These were some of the many questions that Indu asked herself. She knew she had to make a decision quickly. She knew it wasn't really about the money, it was more about the consequences that followed. She wanted to build a strong company with a core ideology that was "built to last" and one that would make a lasting impact on the enterprise software industry. What would be the best way to get there? What were Indu's options? What should she do and why?

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Appendix A - The founding of Serus – a Timeline	
Year	Key event
Feb. 1999	Indu Navar and Barbara Hoefle met for the first time
Jan-July 2000	Indu and Barbara researched extensively into supply chain management (SCM) area, talking to contacts, reviewing market research studies
May 2000	Indu met Dr. Ronjon Nag, CEO & Founder, Cellmania, who offered to give her \$100,000 subject to her securing a customer order
Aug. 2000	Indu and Barbara decided to develop SCM software that could address the needs of global companies and could be customized by users to meet their requirements
Aug.-Sept. 2000	A casual meeting resulted in Indu connecting with executives at Quantum Corporation, a global manufacturer of tape drive and storage products
Nov. 2000	Quantum invited Serus to bid for a contract to provide SCM software
Jan. 2001	Serus won \$250,000 contract from Quantum Corporation; Dr. Nag gave \$100,000 to Indu Navar; Serus had 1 customer and 5 employees
2002	Serus had 2 customers, 7 employees, and \$500,000 in angel funding
2003	Serus had 4 customers and 10 employees
2004	Serus had 8 customers and 19 employees

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**THE SOCIETY FOR
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SHOULD A PROFESSIONAL ASSOCIATION PROHIBIT ITS MEMBERS FROM HELPING THE GOVERNMENT: THE APA INTERROGATION DEBATE

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This critical incident was prepared by the authors. The views presented here are those of the case authors and do not necessarily reflect the views of the Society for Case Research. The authors' views are based on their own professional judgments.

Introduction

Sam Goldberg, Ph.D., sat down at his desk in the San Francisco hotel room. It was August 2007, and the weather was beautiful. When he had left his home state of North Carolina earlier that morning, the temperature had been a blazing 95 degrees with high humidity. He had arrived in San Francisco to a cool 72 degrees with clear blue skies. He had traveled across the country to attend the American Psychological Association (APA) Council meetings that were to begin the next day. It had been a long trip and Goldberg was tired; nonetheless, he knew that he still had work to do to prepare for the meeting tomorrow. He opened his briefcase and removed a manila file folder. The file folder contained papers that had been read and studied by Goldberg many times before.

Goldberg removed the pages from the file and settled back in the vinyl covered hotel chair to reread the information addressing if members of APA could work in interrogation facilities. The APA had already affirmed its stance against torture; however, this new call for a vote had come about because of the reported interrogation activities in Guantanamo. Suspected al-Qaeda terrorists had been imprisoned by the U.S. military at Guantanamo Bay and interrogated on the site employing measures (e.g. sleep deprivation, water boarding) that were considered to be

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cruel, degrading and/or inhumane treatment. The Bush administration had asserted its right to define torture independently of other groups such as the United Nations.

At issue was psychologists' participation in Behavioral Science Consultation Teams or colloquially "biscuit" teams which advised individuals who were involved in questioning and interrogation of prisoners. One side argued that APA member psychologists should not participate in any manner assisting or advising interrogation teams because to do so was to condone morally offensive practices. Thus, they were asking for a moratorium on the involvement of military psychologists in any interrogations. APA members should be banned from interrogation facilities, such as Guantanamo Bay. If they continued to be present, they would lose their APA membership and potentially lose their license to practice. It was suggested that to participate at all, was unethical in a profession that was commonly seen as one of health care providers.

The other side of the debate argued that psychologists were also behavioral scientists and their presence in interrogation facilities served as a check on - and reporting of - abusive practices. They were not directly present during interrogations, but their role was to advise interrogators about such topics as sensitive interviewing, culture, and psychological stress. However, allegations of helping to "break" detainees continued to appear in the media (see article in NYT 6/7/2006). Prominent military psychologists argued that psychologists' presence at interrogation centers reinforced safe practices and prevented abuse. They supported the stance that the APA should condemn individual acts of torture and investigate ethical charges against any psychologist involvement with torture. However, they endorsed the Board of Director's stance that they should be allowed to be work within interrogation centers and remain in good standing with the Association. Another question dealt with whether regulating where someone worked vs. individual behavior was the most appropriate approach to promoting ethical standards.

The debate had been ongoing for over three years (See Timeline, Appendix). When the question first arose regarding psychologist involvement, The APA Board of Directors had initiated a Task Force on Psychological Ethics and National Security (PENS) to study the issues involved. PENS had produced a substantive report with a number of recommendations. However, the report did not satisfy critics who argued in the media that APA had not taken a strong enough stand. At the upcoming meeting tomorrow, the Council Representatives to APA were going to vote. Should psychologists be involved in national security-related investigations? That is, should APA members be allowed to be present as advisors in sites like Guantanamo if the government did not disavow use of questionably cruel or degrading treatment in the interest of national security? Goldberg set the papers back into the dog-eared manila folder. He sighed, removed his glasses, and rubbed his eyes. This was indeed a serious ethical debate that had consequences for national security, psychologists who were serving in the military, and the prisoners subject to interrogation. Goldberg sighed, "How should I vote?"

APA and the North Carolina Representative

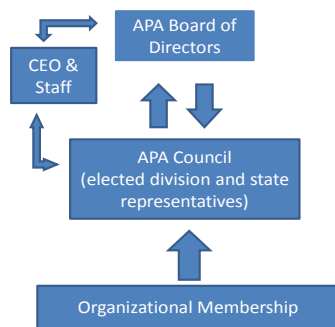
Sam Goldberg had been a practicing clinical psychologist for over 20 years. Goldberg was a Professor of Psychology at Southeastern Carolina State University and also worked in the University Psychology Clinic, designed to provide treatment for university students as well as low income clients in the surrounding community. He specialized in alcohol and drug treatment and had prided himself on keeping up to date regarding best practices regarding treatment. A female graduate student from their training program had accepted an army commission and was heading off to an Army internship with the expectation that she would later serve a tour of duty in Iraq. Goldberg was known by his colleagues to be a thoughtful, intelligent, and caring practitioner. His decision-making style was to consciously collect the best information he could, consider competing interests and perspectives of others as well as possible consequences, but ultimately make up his own mind regarding the best course to take.

In addition, Goldberg also served in his State Psychological Association and had been voted by its membership to represent the State of North Carolina at the national organization for psychologists—the American Psychological Association (APA). At the broadest level, psychologists study behavior and mental processes. They are both scientists (working in such diverse subfields as neurobehavioral development, cognitive and memory processes, psychopathology, personality and social/organizational influences), as well as health care professionals in consulting and clinical roles (e.g., medical schools, Veterans Administration). Within the structure of APA there are over 50 such divisions (including Division 12 Society of Clinical Psychology, Division 19 Society for Military Psychology, Division 38 Health Psychology, and Division 48 called the Society for the Study of Peace, Conflict, and Violence). In addition to divisional representatives, each state, provincial and territorial association elected representatives to APA Council, the association's governing body.

For Goldberg, his election to APA Council was one of serious responsibility. He saw it as an opportunity to serve his colleagues, which numbered about 148,000 including student members. He had joined APA while he himself was a student in graduate school, studying to become a clinical psychologist. His history with the organization was extensive and his serving as the North Carolina representative was a position of prestige. Goldberg knew that serving well required effort and conscientiousness on his part, and he felt obligated to share association information including his voting record with other North Carolina psychologists.

The APA Council was a large group made up of 175 diverse representatives. Although the association has a 12 member Board of Directors (Officers and seven Members at Large elected by Council), Council itself had the authority to develop and oversee all policies of the Association. Figure 1 depicts the organization's governance structure.

Figure 1: APA Governance



The Council met twice each year—in February in Washington, D.C. and August in various locations in concert with the annual convention. It had “full power and authority over the affairs and funds of the Association . . . including the power to review, upon its own initiative, the actions of any board, committee, division, or affiliated group” (www.apa.org).

APA membership in good standing yielded practical consequences for psychologists. The association was by far the largest group of psychologists working jointly to advance psychological knowledge in research, professional practice and the public interest. All States required that practicing psychologists complete an accredited training program and be licensed in their respective State to practice, with the majority of the States’ requiring that psychologists adhere to the APA Ethical Principles and Code of Conduct. APA’s role as a governing organization over its members was clear. To most psychologists, it mattered if one were a member of APA and recognized as a psychologist.

The APA Council and the Interrogation Debate

In August 2004, Goldberg had been present at the APA meeting. The meeting day had been long, and since the meetings had been held in Honolulu, Hawaii, he had been looking forward to hiking up the Diamond Head Crater Trail that would bring him to a panoramic view of Honolulu and Waikiki Beach. However, he forgot about his desire to hike up Diamond Head when questions were first raised regarding psychologists’ involvement in interrogations. The issue was considered in the context of the APA Ethics Code with its principles of beneficence and nonmaleficence, fidelity and responsibility, integrity, justice, and respect for people’s rights and dignity.

By the Council's next meeting in February 2005, a special task force to explore the ethical aspects of psychologists' involvement and the use of psychology in national security-related investigations was formed. The task force, PENS was charged to examine whether the current APA ethics code adequately addressed and guided psychologists' involvement in national security-related activities.

APA next met in Washington, D.C. Goldberg attended Council and listened intently to the PENS report. PENS stated that it believed that a "central role for psychologists working in the area of national security-related investigations is to assist in ensuring that processes are safe, legal, and ethical for all participants" (APA, 2005). PENS also reported that the existing APA ethics code addressed the ethical dilemmas that may arise in national security-related work through its focus on the general ethical principles cited above. To elaborate, PENS listed 12 statements concerning psychologists' ethical obligations in National Security-Related Work and referred to specific text from the Code of Ethics. The Code stated that psychologists respect and protect civil and human rights; psychologists seek to safeguard the welfare and rights of those with whom they interact professionally; psychologists exercise reasonable judgment and take precautions to ensure that their potential biases do not lead to or condone unjust practices; and psychologists respect the dignity and worth of all people (APA, 2005). It was recognized that health care related information from an individual's medical record should never be used to the detriment of an individual's well-being and that health care provider and consultant roles should not be mixed. Further, it reported that the APA's existing Human Rights Resolution against torture and other cruel, inhuman, and degrading treatment addressed appropriate behavioral standards for psychologists and condemned torture and other cruel, inhuman, and degrading treatment.

However, the debate about psychologists' roles in interrogation continued. At the February 2006 meeting, the Chair of the PENS Task Force reaffirmed APA's position that "psychologists cannot engage in, direct, support, facilitate, or offer training in torture or other cruel, inhuman, or degrading treatment" (Moorehead-Slaughter, 2006). However, the Division of Peace Psychology was concerned about a potential loophole in the existing Ethics Code. Specifically, in response to court ordered testimony, one standard in the code (1.02) relating to conflicts between ethics and legal authority directed psychologists to make known their commitment to the Ethics Code in trying to resolve such conflicts but ultimately allowed adherence to the requirements of law, regulations, or other governing legal authority. The adequacy of the code was questioned with calls for greater guidance and a casebook for psychologists involved in PENS activities.

In August 2006, APA Council met and heard opposing views on the role of psychologists in interrogations. Lt. General Kevin C. Kiley, Surgeon General of the U.S. Army, supported APA's current stance and spoke about psychologists providing health care to soldiers and families as well as the separate role of psychologists advising interrogation teams. Kiley stated that military psychologists were able to do their jobs and adhere to the APA ethics code. Dr. Steven Reisner,

senior faculty member at Columbia University's International Trauma Studies Program, did not agree with Kiley about psychologists and their presence during interrogations. He asserted, "Psychologists should not be present at Guantanamo or places like it". Council then passed a revised resolution against torture updating the prior resolution to include UN definitions and standards (Goldberg, 2006).

Although attempting to clarify the ethical obligations of consulting psychologists, the PENS report received more criticism than praise (See Carter & Abeles, 2009). Media responses may have created a negative impression of consulting psychologists based on the alleged actions of a few without any formal accusations. Groups such as Physicians for Human Rights argued that the report did not offer a clear, explicit ban on coercive interrogation strategies. News analysts even argued that leadership on APA Board of Directors was influenced by political-economic considerations given that the history of psychology as a profession was linked to testing and psychotherapy as part of prior wars and the development of the VA system which still employs many psychologists today (*Washington Monthly*, 1/2007).

There was little mention of the growing controversy at the February 2007 meeting. However, for the upcoming August 2007 Council meeting, a representative of a coalition of Divisions for Social Justice proposed a motion for a moratorium on psychologists' participation in detention facilities for foreign detainees. The APA Board of Directors remained unconvinced and offered a substitute motion that reaffirmed and elaborated on the APA's already stated position against any acts that could be considered torture or otherwise degrading treatment.

In the halls between meetings and in smaller caucus groups, Goldberg participated in discussions with other Council members about the motions. There was agreement that information obtained through extreme distress or torture may be of questionable accuracy. Simply put, no psychologist on Council was for torture. Further, there had not been a complaint lodged about any psychologist regarding this matter. As an association, APA stood for all psychologists-psychoanalysts and behaviorists, those working for the underprivileged and those in government settings; yet, this had the feel that the APA house was being fractured. Would such a ban force military psychologist to lose their good standing with APA?

Goldberg picked up the pen on the desk in the hotel room, opened the desk drawer and removed a second sheet of hotel stationery. He drew one line to create two columns on the paper. At the top of one column, he wrote "Kant—Do no harm." At the top of the other column, he wrote, "Mills and Utilitarianism—look at the consequences." From his own education, Goldberg knew that these were the two great ethical traditions (e.g., see Hartman & DesJardins, 2008; Koocher & Keith-Spiegel, 2008), and he relied upon them to help him decide how to vote. Goldberg fully believed and supported the general ethical principles of nonmaleficence and respect for people's rights and dignity. He also believed and supported that his military psychologist colleagues were good people who worked in extremely difficult circumstances. How should he vote? Should he

vote for the moratorium and ban psychologists from being involved in detention facilities? Or, should he support the Board and psychologists' presence at detention facilities?

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Appendix: Timeline: Chronology of Events in APA Interrogation Debate

Dec '04 APA Issues Statement of Concern regarding involvement of psychologists in interrogations announcing their intent to understand roles psychologists assume in national security endeavors and to determine whether APA Ethics Code has given adequate ethical guidance for their work-related activities

Feb '05 Board approves Task Force to Explore the Ethical Aspects of Psychologists' Involvement and the Use of Psychology in National Security-Related Investigations

June '05 Task Force on Psychological Ethics and National Security (PENS) issues report

August '05 APA Council approves resolutions related to PENS Report including reaffirmation of 1986 Resolution against Torture and Other Cruel, Inhuman, or Degrading Treatment, a commentary process, collaborative efforts between PENS Task Force and the Ethics Committee, and a directive to refer specific allegations against any APA member to Ethics Office.

February '06 Council Receives Update on Implementation of PENS Resolutions by Dr. Moorehead-Slaughter (Chair Task Force and Ethics Committee). These included dissemination of Resolution against Torture and ongoing efforts to develop a commentary/ casebook related to PENS report. The Divisions for Social Justice propose further actions such as drawing on international convention to define terms (e.g., "torture, cruel and degrading") citing related documents, and further develop educational materials on ethical issues raised. Related article appears in *Monitor on Psychology*, April 2006.

Debate continues. Dr. Koocher's responds to NY Times article (June 7th) "Military Alters the Makeup of Interrogation Advisors". A continuing issue is whether section 1.02 of Ethics code allows a loop-hole for psychologists following military orders.

August '06 APA Council heard two presentations related to PENS. The first was by Lt General Kevin Kiley (Surgeon General of Army) who spoke about psychologists providing health care to soldiers and families as well the separate role of psychologists advising interrogation teams. The second was by psychologist Dr. Steven Resner (Columbia University), a critic of the PENS report. Council passed a revised resolution against torture updating the prior resolution to include UN definitions and standards. Ethics Committee is examining, revising and/or amending 1.02. President of APA, Dr. Koocher, was directed to write a letter of appreciation to all psychologists working in the military, National Guard and Veterans Administration to commend them for their many significant contributions and personal sacrifices. Articles by Dr. Gerald Koocher and Stephen Behnke (APA Ethics Office) appear in July/ August (2006) issue of *Monitor on Psychology*

August '07 VOTE. Council is asked to vote on a resolution calling for a moratorium on psychologists' participation in detention facilities for foreign detainees.

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SONOMA WINE COMPANY: ABSOLUTE OR INTENSITY TARGET FOR GHG EMISSIONS?

Asbjorn Osland, San Jose State University

This case was prepared by the author and is intended to be used as a basis for class discussion. The views represented here are those of the case author and do not necessarily reflect the views of the Society for Case Research. The author's views are based on his professional judgment.

Introduction

The Sonoma Wine Company (SWC - www.sonomawineco.com), the largest custom crush services provider in Northern California, was privately held, owned by Derek Benham. SWC was located north of San Francisco in Graton in Sonoma County, home to many winemakers. It focused on contract wine production and had doubled its production over the last five years to three million cases bottled annually for over 30 clients, with more than 75 labels in the popular premium to luxury categories. SWC provided a full range of wine making services (i.e., crush, press, fermentation, barrel aging and storage, stainless tank storage, and bulk wine tracking and inventory management, using Advanced Management Services software <http://www.amssoftware.com/>). According to SWC's website: "From the time juice or bulk wine arrives at the winery, every movement, addition, chemical analysis and process is recorded and tracked on a daily basis or by our bulk wine tracking team. Each month clients are furnished with a detailed history of their inventory."

In doubling its capacity, the Sonoma Wine Company (SWC) successfully reduced its energy consumption and made more efficient use of water. In the process it adopted an absolute target for greenhouse gas (GHG) emissions, i.e., "Sonoma Wine Company pledges to reduce total U.S. GHG emissions by 15 percent from 2005 to 2010" (retrieved on April 15, 2009 from <http://www.epa.gov/stateply/partners/partners/sonomawinecompany.html>). As a member of the Environmental Protection Agency's Climate Leaders program, it could have opted for an intensity target (i.e., reduced GHG emissions per unit of manufacturing target, in this situation

measured in fewer GHG emissions/case of wine from time 1 to time 2), which would have allowed it to increase the overall GHG emissions due to growth (i.e., an absolute increase). The absolute target was difficult to achieve due to SWC's capacity growth whereas the intensity target would have been readily achieved. Natasha Granoff, SWC's Director of Business Development and in charge of sustainability at SWC, wondered if an absolute target was the appropriate decision? What were the risks associated with failure to meet the absolute target?

Sustainable Business Practices Journey

SWC focused on resource conservation, solid waste management and state of the art waste water treatment technology. It was also involved in local groups committed to sustainability (e.g., Sonoma Green Business Program - <http://www.sonoma-county.org/sonomagreen/> - and the Wine Institute's Sustainable Winegrowing Program - <http://www.wineinstitute.org/initiatives/sustainablewinegrowing>). Still, the executive team knew it had to do more to conserve energy. In 2003, SWC decided to launch an expansion program that was to double the business in five years. Its executives thought the permit application would more likely be approved if the local community and public utility that provided power participated in the planning. Natasha stated that though energy conservation was obvious, "making the carbon connection and reduction of GHG's was a cultural shift." Planning, both financial and operational, was no longer done independent of environmental considerations.

One early capital budgeting decision that integrated environmental, financial and operational planning occurred when SWC considered solar photovoltaic panels, a green technology that was fashionable in California because of its regular sunlight and the green movement popular in wine country. However, the 2003 bid resulted in a payback of 25 years assuming a system capacity of 2,003 kilowatts. At that time, the critical priority in terms of capital investment was to rectify the inefficiencies that resulted from the prior lack of maintenance. Natasha concluded, "In doing so we realized focusing on energy efficiency was a quicker payback, much less capital intensive and would allow us to size an alternative energy system appropriately." Solar was simply too expensive at the time though SWC was open to revisiting it in the future when costs fell.

SWC was encouraged by John Garn who wrote about the SWC (2007). He was an environmental consultant that continued to explore with SWC how to be sustainable. In 2003, he urged SWC to take the sustainable winegrowing assessment as well as suggesting that it contact John Rosenblum for its waste water concerns and other topics relating to sustainability. "All roads lead to John Garn!" according to Natasha.

Natasha knew that establishing a baseline assessment was crucial so that SWC could monitor its progress, compare itself to other wineries, and better understand the problems they faced. The instrument they selected in February 2003 was the Sustainable Winegrowing Practices assessment, published by the California Sustainable Winegrowers Alliance (CSWA <http://www.sustainablewinegrowing.org/>). "We realized we couldn't define where we needed to

go to accomplish our goal of 100 percent production increase until we understood where we ... were," Natasha said. Going through the assessment gave everyone a better understanding of what they were doing to conserve resources and where they were expending energy.

Then in 2005 it did an inventory of its greenhouse gas (GHG) emissions as a member of the Climate Protection Campaign (CPC - <http://www.climateprotectioncampaign.org/>), a neighboring organization and a national leader in assisting organizations to reduce their GHG emissions. Natasha enlisted the assistance of an analyst for the CPC, who calculated, based on historical data from the public utility (Pacific Gas & Electric - PG&E) that SWC used. This was calculated at 74 kWh per case of wine and therefore generated .44 pounds of CO₂ per case of wine. SWC executives reviewed their customized CSWA report that compared them to over 100 other state wineries and found that they needed to improve energy efficiency. They had to understand more precisely, "Just exactly how much water, energy and wastewater discharge is related to every case of wine we produce?"

In 2005, SWC invested half a million dollars in efficiency measures. PG&E had provided it with incentives that covered 33% of its costs. The outcome was a seven percent reduction in electricity and 36 percent decline in the use of natural gas. At the same time, production had increased 28 percent. Its efforts won it recognition in 2005 by PG&E as a leader in energy conservation. Its long-term project planning came to include water and energy saving measures as a matter of course. It had established a favorable reputation with PG&E that would help it later when it became part of the Savings By Design program, an effort by PG&E to assist companies make design changes that enhanced resource and energy conservation. The chronology of SWC's sustainability program is described in Table 1:

Table 1
Chronology of sustainability program

2003:

- SWC decided to launch an expansion program that was to double the business in five years.
- John Garn, environmental consultant, encouraged SWC to take the sustainable winegrowing assessment.
- SWC selected the Sustainable Winegrowing Practices assessment tool.
- Garn also suggested SWC contact Dr. Rosenblum.

2005:

- SWC did an inventory of its greenhouse gas (GHG) emissions as a member of CPC.
- SWC invested half a million dollars in efficiency measures. Its efforts won it recognition in 2005 by PG&E as a leader in energy conservation.
- Its long-term project planning came to include water and energy saving measures as a matter of course.
- SWC improved the water treatment system with efficient aerators and dissolved oxygen controls.

2006: SWC became an EPA Climate Leader and pledged a 15% reduction in total GHG emissions by 2010.

2007: Savings By Design (<http://www.savingsbydesign.com/>) report completed.

2008:

- From 2005 to September 28, 2008, SWC achieved the following resource savings and GHG emissions reduction (SWC, 2008): decreased wastewater generation per case from 3.81 to 3.14 gallons or 22%, decreased natural gas use per case from .025 therms to .014 therms or 48%, decreased electricity use per case from .75

kWh to .58 kWh or 29% and GHG reduction ... 436 metric tons of CO₂.

- The reduction of GHG emissions was accomplished while boosting production without additional refrigeration tonnage (SWC, 2008): bottling from 1.78m/year to projected 2.6m/year by end of 2008, or 46% increase, tank storage from 1.19m gallons to 1.36m gal, or 14% increase, and barrels stored from 30,534 to 45,153, or 48% increase.
 - To accomplish the preceding SWC did the following during 2004-2007 (SWC, 2008): insulated 50 wine tanks, insulated glycol storage tank to reduce energy load, installed hot water storage tank to reduce energy load, replaced water boilers with 87% efficiency water heaters, replaced metal halide lighting with high efficiency T-5 fluorescents, replaced air compressor with variable speed on demand features, variable frequency drives on motors, waste water monitoring system to regulate aerator use, Cool® roof -foam insulated, reflective roofing, hot and cold supply line insulation, glycol cooling system (replaced Freon air handler units).
 - Water and wastewater efficiency upgrades resulted in an estimated savings of 33 % in water usage.
-

Absolute versus Intensity Targets

In 2006, SWC became an Environmental Protection Agency (EPA) Climate Leader (<http://www.epa.gov/climateleaders/index.html>). According to the EPA, Climate Leaders was an industry-government partnership focused on reduction of GHG emissions by participating organizations, which must monitor progress through periodic emissions inventories. Natasha was quoted by the EPA: “Acknowledgment of the true cost of running a business is the first step to a pledge to reduce greenhouse gas emissions. The goal and the power of EPA’s Climate Leaders Program and organizations like Climate Protection Campaign are to challenge us to see our business clearly and to understand the mark we leave on a daily basis in our communities and surrounding environment.”

There are pros and cons to both intensity and absolute goals. The primary benefit of absolute targets is that it defines a limit on GHG emissions thereby contributing to overall global warming mitigation. Intensity targets can demonstrate greater efficiency but if production increases then it’s possible that overall GHG emissions will increase and contribute to global warming. Jim Sullivan of the EPA Climate Leaders Program (personal communication, September 18, 2007) stated:

A current trend is that many companies are finding enough cost-effective reduction opportunities to reduce overall corporate emissions despite rapid growth. Many of our partners find that it is doing the everyday operations and management right that leads to the biggest savings, since there are no major capital investments involved. In addition technology and energy prices change rapidly and can quickly affect project economics. Many of these partners are putting in what I would call third or fourth generation projects (i.e., landfill gas powered cogeneration, on-site solar/fuel cells/wind, solid state lighting) and are finding reasonable returns based on project economics as well as state tax breaks/incentives for newer technologies. There are a lot of good greenhouse gas reduction and energy efficiency projects that can be done cost-effectively with current energy prices and technologies.

When questioned about saving face with the EPA, Natasha then added:

It is not a question of saving face with the EPA. Climate Leaders is a voluntary program that encourages communication about goal setting and strategies. EPA's goal monitoring is third party verification, which provides us with accountability. Still, there is an annual check in offering a chance to modify or change goals. We face the challenge of growing a company quickly and planning appropriately to keep energy use in line. For me personally, setting an absolute goal is acknowledging and understanding global warming, the effects of climate change and reacting responsibly. That means changing not only behavior but the business model. I thought setting intensity goals was a cop out and potential for "green-washing," where we look like we're doing the right thing but could be doing more. But our growth has been so fast over the last two years and our business planning reactive not proactive that I understand the difficulty in maintaining absolute goals.

Sustainability became a goal for Natasha and in turn for the SWC that allowed the executives to overcome differences in approaches or biases and fostered a clear focus. Measured results became the basis for discussion, rather than power related to hierarchical rank. The 1987 Brundtland Commission defined sustainability as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs" (World Commission on Environment and Development, 1987). For her and others that accepted the premise that sustainability was critical to avert global warming, the absolute emissions target became an overarching goal that permitted her and her peers within SWC and outside in the green networks (e.g., Sonoma County Green Business program, the Wine Institute's Sustainable Winegrowing Program and the EPA Climate Leaders) to focus on GHG emissions reductions. Such a goal motivated supporters to overcome differences because they believed that mitigating the harmful impact of global warming was crucial. Even for those that saw sustainability as a way to use resources more effectively and efficiently, reducing waste and emissions led to lower costs, which was something they could all agree upon. The sustainable business themes delineated by Natasha are listed in Table 2:

Table 2
Sustainable business themes

-
- *Overarching goal.* The practical measure of lower costs helped the SWC personnel decide against the solar photovoltaic technology mentioned above.
 - *Expert consultation.* Natasha needed the assistance of John Garn, John Rosenblum and the experts from PG&E.
 - *Membership in green associations.* It joined the previously mentioned green organizations to network with other people with common interests.
 - *Capital budgeting to include sustainability.* Natasha stated that though energy conservation was obvious, "making the carbon connection and reduction of GHG's was a cultural shift." Financial and operational planning was no longer done independent of environmental considerations. Sustainability investments often lose out to ones that leaders perceive as more immediately crucial to the bottom line.
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- *Task forces and Savings by Design.* SWC had moved into a continuous improvement mode through their task forces that had worked well. They worked on water and energy in a continuous improvement effort. Small changes, such as better insulation, were also important to continuous improvement. SWC used Savings by Design for its discontinuous change. Dr. John Rosenblum believed he could incorporate energy efficiency into his wastewater analysis and SWC would then be eligible for a rebate package on its large project. As a result, SWC had energy savings, between 2004-2007, of \$16,679, and utility rebates of \$187,292.
 - *Monitoring and measurement:* Natasha knew that effective goals had to be quantified and be difficult but not impossible to achieve. SWC developed the ability to monitor what it had accomplished in terms of energy and water efficiency. It was critical to develop reliable (i.e., measures the same repeatedly) and valid (i.e., one has identified the correct factor) monitoring systems. Objective data facilitated dialogue between task force members. Data-based dialogue enabled subordinates to enter into discussions with superiors and confront them, if that was what the data indicated.
-

Discouraging recent report

The report Natasha had just scanned indicated that their progress was somewhat flat and the trend indicated that it would be difficult to make the 2010 target in terms of absolute emissions. Had she made a mistake in not selecting the intensity option? What difference would it make? What should Natasha do?

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**THE SOCIETY FOR
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SPEEDING TOWARD TROUBLE: JAY PEAK RESORT VERSUS THE TOWN OF NORTH TROY, VT.

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This case was prepared by the author and is intended to be used as a basis for class discussion. The views represented here are those of the case author and do not necessarily reflect the views of the Society for Case Research. The author's views are based on professional judgment.

Bill Stenger, President of Jay Peak Ski Resort in Jay, Vermont, watched a couple bickering loudly in French approach the entrance to Jay Peak's lodge. As a longtime resident of northern Vermont, Stenger knew enough French to pick out the words "police", "speeding ticket", and "fine." Immediately Stenger knew the pair were the latest victims in an ongoing battle between Jay Peak Resort and the village trustees in North Troy, a tiny village that hugged the Canadian border. Three years ago, the trustees had hired part-time constable Larry Zenobos to restore order in the unruly village. One of Zenobos' duties was to safeguard residents from Canadian motorists who roared through North Troy as they rushed to travel the final ten minutes to Jay Peak. The constable enforced North Troy's 25 mile-per-hour speed limit aggressively, issuing speeding tickets to unsuspecting Quebecers in what Stenger claimed were disproportionate numbers. Such a ticket would ruin a skier's outing before it began, and Stenger believed that Zenobos' enforcement practices actively discouraged Canadian skiers from patronizing the resort.

To date, Stenger's appeals to North Troy's constable and village trustees had gone largely ignored; Zenobos continued to issue speeding tickets freely. While he did not condone unsafe driving or question the trustees' duty to safeguard residents, Stenger knew he had to do something—his business depended on it. But what could he do to resolve the problem?

Jay Peak: The Skier's Mountain

Founded in 1955, Jay Peak is a 385-acre four-season resort located in Vermont's Northeast Kingdom (anonymous, 2003a). The mountain's location and elevation (2,152 vertical feet) combine to create extraordinary amounts of powdery snowfall—at up to 300 inches per year, the heaviest accumulation of snow east of the Mississippi River (Jay Peak Area Chamber of

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Commerce, 2008). Heavy snowfall, extended ski seasons, challenging trails, and extensive glade skiing earned Jay a reputation as a “skier’s mountain,” with conditions rivaling those found among the finest resorts in the west. In addition to lifts and an aerial tramway, the resort featured a lodge, pool, hotel, and condominiums that were rented to skiers by the week (a \$10 million 18-hole golf course was completed in 2006) (Russell, 2006). During the ski season, Jay Peak employed approximately 400 employees, making the resort the largest employer in the area (Ring, 2006).

Because it required at least 90 minutes to drive to Jay Peak from Burlington—Vermont’s most populous city—and local residents in nearby villages had little discretionary income, the resort relied heavily on the custom of Canadian skiers traveling from Montreal and Quebec’s eastern townships. Although Canadian ski resorts Orford and Sutton were closer, neither boasted the conditions and challenges featured at Jay Peak. Bill Stenger worked hard to lure Canadian tourists to his resort: in 2006, approximately 100,000 visited Jay Peak. Quebecers comprised 55% of the resort’s clientele and 65% of the resort’s 3000 season tickets holders (anonymous, 2003b). Unlike local Vermonters who paid discounted prices for lift tickets, Canadian skiers without season passes were charged full price (anonymous, 2003b).

Jay Peak was not the only business that relied on Canadian tourists. The mountain was ringed by tiny villages filled with convenience stores, motels, restaurants, pubs, ski and snowboard shops, gift shops, and vacation homes that were rented to tourists by the week. Although the Northeast Kingdom’s covered bridges and colorful autumn foliage drew tourists throughout the year, the bulk of sales revenue was collected during the busy ski season (usually early November through late March).

Slowing Down Crime in North Troy

In 2003, the village of North Troy experienced a crime wave—break-ins, burglaries, vandalism, harassment, speeding, and driving all-terrain vehicles on village streets were rampant. Although the village paid the county sheriff’s department \$8000 per year for 15 hours of policing per month (Breummer, 2004), the perpetrators were usually long gone by the time deputies arrived. Village trustees decided to take matters into their own hands by hiring Constable Larry Zenobos to provide 30 hours of policing per week for a salary of \$35,000/year (Brueimmer, 2004). Using vigilance and aggressive enforcement, Zenobos quickly cleaned up the break-ins, vandalism, and illegal four-wheeling. However, slowing down speeding drivers proved to be a greater challenge.

Speeding and reckless driving were particular concerns for Zenobos. After driving about 75 minutes at 110 km/h (approximately 70 miles per hour) from Montreal and passing through U.S. Customs at the U.S./Canadian border, most skiers were anxious to travel the final six miles to Jay Peak. Many passed through North Troy—which lay between the border and the resort—without slowing down (see Figure 1). While the speeding was dangerous enough, the layout of North Troy increased the hazard. Houses sat close by the streets, and children and pets played in

front yards. The village had no sidewalks, forcing pedestrians to walk along the side of the road. During the winter, plows heaped snow on the roadsides, forcing pedestrians to share the streets with traffic. The danger inherent in this situation became clear after a speeding Quebecer crashed head-on into the constable's cruiser, even though the police car was parked on the roadside with blue lights flashing. The cruiser was a total loss (Breummer, 2004).

To take on speeders, Constable Zenobos set up a radar gun at a four-way intersection about a half mile inside the village limits, where the speed limit dropped from 40 miles per hour to 25 miles per hour. There he would lie in wait for speeders who failed to slow down as they drove into town. Zenobos ticketed speeders aggressively, reasoning that he'd "rather ruin (a speeding motorist's) day in order to avoid having a tragedy and having everybody's day ruined" (Breummer, 2004).

An Appeal from President Stenger

Due to Constable Zenobos' efforts, Bill Stenger received mounting complaints from customers ticketed on their way to Jay Peak. Stenger realized that the ticketing angered and frustrated customers, ruining what would have otherwise been a positive tourist experience. "We work very hard to let it be known that we're open for business," Stenger noted; the aggressive speed enforcement "doesn't make (customers) feel welcome" (Ring, 2006). He also reasoned that "one person who gets a speeding ticket and refuses to come back (to Jay Peak) will probably warn off 50 potential customers" (Ring, 2006). In an attempt to address the problem, Stenger attended a public town hall meeting in early 2006 to appeal for relief on his customers' behalf.

At the meeting, which was well-attended by North Troy residents, Stenger argued vigorously with the trustees about the village's speed enforcement policy. While he supported the goal of protecting North Troy residents from dangerous drivers, Stenger argued that the policy was flawed in several respects:

- Stenger claimed that Zenobos focused on ticketing Canadian tourists rather than locals (Ring, 2006). Because Canadians were less likely to return to North Troy to appeal a ticket in traffic court, they were more inclined to plead guilty to the speeding charge and pay the fine. The cost of an average speeding ticket in North Troy was \$172.94 in 2004 (Breummer, 2004).
- Stenger also argued that the area where the speed limit dropped from 40 miles per hour to 25 miles per hour was too restrictive, giving drivers little opportunity to respond (Ring, 2006). The speed on Route 234 was posted at 40 miles per hour just inside the U.S./Canadian border. A short distance later a sign warned that the speed limit was being reduced to 25 miles per hour ahead. Another sign located at the bottom of a downhill curve posted the speed limit as 25 miles per hour. Stenger estimated that the warning and speed limit signs were located only 100 feet apart—too short a distance to safely slow down given that drivers were headed down a winding hill. Stenger argued

that the unreasonably close placement of the signs created a speed trap designed to ensnare motorists. "It just stinks," he complained (Ring, 2006).

- Finally, Stenger noted that any policy which harmed the resort also harmed the local economy. Jay Peak was the largest employer in a region that offered few job opportunities, particularly during the busy winter season. Aggressive ticketing was driving away Canadian tourists and the dollars they contributed to the local economy; it was possible that North Troy was protecting residents and collecting fines at the expense of Jay Peak's employees and the economies of surrounding villages.

Village trustees were unmoved, however. "If you don't want any encounters with our police department, don't (speed)," opined village trustee President Rene Patenaude. "Just do what you're supposed to do. It's that simple" (Ring, 2006). Constable Zenobos was also unimpressed. Residents of North Troy were grateful for his efforts, the constable noted; the town was safer and crime statistics had dropped sharply since he had assumed his post. Zenobos dismissed Stenger's claim that he unfairly targeted Canadians passing through North Troy, noting that Quebecers received twice as many speeding tickets as locals because they drove like "bats out of hell" when passing through the village. "Come and sit in my cruiser for a weekend and...you'd be absolutely appalled (by the speeders)," he retorted (Breummer, 2004). As for the Jay Peak President's claims regarding the local economy, Zenobos accused Stenger of valuing profits more than public safety.

Stenger Strikes Back

Stung by the trustees' rejection, Stenger decided to take matters into his own hands--if the leaders of North Troy would not alter their policing practices, he would launch a campaign to warn motorists of the speed trap. Jay Peak brochures began to carry a warning to slow down in North Troy; a similar warning was posted on the resort's website (Ring, 2006). Stenger also posted a sign a half mile inside Canada to warn motorists approaching the border of the "speed trap" in North Troy (Ring, 2006). Finally, on days when Zenobos had set up his radar in the village, Stenger stationed Jay Peak employees alongside the road approaching North Troy to hold up signs that warned "Speed trap ahead!" and advised motorists to "Slow down now!"

Stenger's actions may have protected some customers from being ticketed, but they also escalated the feud with Zenobos and North Troy's leadership. Constable Zenobos complained that Stenger dispatched his employees only on days that he conducted radar checks. Consequently, motorists who passed through North Troy regularly quickly realized that an absence of sign-wielding employees meant no police were waiting for speeders. This signal served as a "green light" to people intent on speeding through the village. "You might as well have a neon sign that says, 'There are no police today,'" Zenobos spat (Ring, 2006). Resentful of what he viewed as interference with the law, Zenobos vowed to enforce speed limits more aggressively than ever.

Stenger's Dilemma

As the 2007 ski season approached, Bill Stenger knew that he needed to do something about the dispute with Zenobos and North Troy's trustees. His efforts to shield customers from the constable's radar gun helped his business, but it had only increased Zenobos' resolve to target speeders, thus increasing the problem. Moreover, the feud with North Troy officials was garnering unwanted international attention; major newspapers in Burlington, Vermont and Montreal, Quebec had carried stories about the dispute, in which Zenobos made unflattering statements about Stenger's apparent disregard for the safety of local residents and law enforcement (see Breummer, 2004; Ring, 2006). But what more could he do? Was there a solution to the problem that would protect North Troy residents, his customers, and his reputation?

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TO BID OR NOT TO BID? IS IT TIME TO PURCHASE AN INVESTMENT HOME, MAYBE A FORECLOSURE?

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This case was prepared by the authors, and is intended to be used as a basis for class discussion. The views represented here are those of the case authors and do not necessarily reflect the views of the Society for Case Research. The author's views are based on their professional judgment.

Was it time? Was it time to buy a foreclosure rental property? Jim already owned one rental property in a college community but investing in a foreclosure property was something new for Jim. The prospect of purchasing a foreclosure property was appealing. Real estate prices were down across the country. An increasing number of foreclosed properties were for sale in the local market. Could Jim pick one up for a great price? And what about risks? The market could continue to decline, and what looked like a value might not be. Any home Jim bought would not be his primary residence. Instead he and his wife would rent the property. The rental market could change and the estimated cash flows might not materialize. Foreclosure presented another obstacle as well; it was a bidding process that required cash funds. Jim had the cash available and his decision ultimately came down to getting the “right” price for a property. Determining the right price for the property involved assessing the appropriate cash flows, estimating a cost of capital and assessing the risks associated with his cash flow estimates.

Jim lived in a small university town in Idaho. He owned his primary residence in an area of town known as upper university. The area was up a gentle hill from the main campus of a regional university. All of the houses in this area were within a ten minute walk from campus. The other area close to campus was called lower university and Jim owned a rental here. It too was within a ten minute walk from campus. Jim was a professor on campus and liked having his rental close to his primary residence. It made it easier to keep an eye on the property. It also saved time when he had to stop by to make a repair. Jim's rental property had stable, longer term tenants. Jim had been looking around for another rental but appropriate homes for sales

were scarce in the university areas. Jim was very interested when he noticed a foreclosure for sale about a block from his current rental property.

The U.S. Housing Market

Jim had a great experience so far with his rental but he knew markets and the economy can change. Investing in a second rental was a big step. Jim had moved to Idaho from Las Vegas the year before, in the summer of 2007. Jim's house in Las Vegas sold, but at a price lower than he wanted. Jim quickly realized his sale in the Las Vegas market was actually well-timed because the real estate bubble had already been starting to burst. The housing market seemed stronger in Idaho, and Jim bought his first rental when he moved. Now that he was thinking about buying another rental, Jim realized there were some changes in the U.S. housing market in the summer of 2008 he needed to consider.

Jim kept abreast of the news and heard a radio show describe how in the summer of 2008 the national real estate market was beginning to collapse. There was a run on Bear Stearns and the Federal Reserve had lowered interest rates to combat a subprime lending crisis. The news story described how this crisis occurred after several years of relaxed bank lending practices. Investors were interested in high interest, low risk bonds, and historically mortgage backed securities issued in the United States were just that. With high demand for mortgaged backed securities, mortgage companies began making riskier loans to create more securities. In an effort to increase loans, mortgage companies made loans without verifying income. They were called no income verification loans and were popular. In a no income verification loan the borrower needed only to state his or her income. For due diligence, the banks had an "expert" state that it was possible for someone in the profession of the borrower to make the income the borrower claimed. In addition, many loans were made with nothing, or little down.

The decline in housing prices in some parts of the country started back in 2006. By 2008 the consensus was that the U.S. real estate bubble had popped. While home prices declined, the value of the U.S. dollar declined, and gas, food, and adjustable rate interest rates all increased. There were concerns the U.S. might be entering a recession. Unemployment was increasing. Many people who had been barely able to qualify for a loan stopped making payments and many properties foreclosed.

In Las Vegas and Southern California one in every 40 houses on the market was a foreclosure. While foreclosures were most common in the areas that had the greatest house price appreciation – Arizona, Florida, California and Nevada – they were becoming a more common occurrence throughout the country.

The Local Housing Market

Most real estate agents will state that real estate markets are local. Home prices can drop in one part of the country but remain strong elsewhere. Jim's new hometown had about 50,000 residents. The university was a large employer. The real estate and real estate rental market were affected by enrollments. After years of strong growth, the university's enrollment was dropping. The city did not have a large industrial base and industry and retail continually moved in and out. A vibrant economy with a solid industrial base eluded the city. While Jim's new hometown did not have the price appreciation of Las Vegas during the boom years, as of yet, it did not appear to have the price drops associated with the popping of the real estate bubble. Data on the local housing market was hard to find. The size of the town and the lack of homes for sale made it difficult to gauge how prices changed. In the summer of 2008, it appeared that price appreciation was relatively flat over the prior year. A local realtor estimated prices would continue their upward trend of 5% a year and a local mortgage lender estimated they would decline by 5% or more from the prior year. The tax assessor had a different perspective and said estimated prices would not change.

There were more houses for sale in some parts of town but not in the upper and lower university area. Houses in this area sold quickly to families or investors, and foreclosures were fairly unheard of. It was a good rental area because students liked the convenience of living close to campus. While Jim always kept an eye out for another investment property, there weren't many options. Then Jim saw a house on Trenton Street that was in foreclosure and listed for sale. Jim realized he needed to better understand what was involved in bidding on a foreclosure.

The Foreclosure Process

A foreclosure occurred if a borrower stopped making payments on a house. If the bank and borrower could not work out new terms, the bank could put the home up for sale and try to cover the loan.

Homes were often placed on the market before the house was in foreclosure. The first step was pre-foreclosure. The bank filed paperwork indicating the property would go into foreclosure. During this time the trustee (bank) would accept an offer if it was greater than the loan amount, realtor and attorney fees. If the offer was lower than the mortgage, attorney and realtor fees, then one of the fees would need to be reduced for the offer to be accepted. For instance, the realtor might lower the commission, or the bank might take a short sale. A short sale occurred if the property was sold for less than the current amount outstanding on the loan. Often a foreclosure was auctioned. Bidders at the auction needed a certified check (or cash) for the amount of the bid. A certified check guaranteed that the person had the funds in the bank associated with the bid. Most potential buyers did not have the large sums of cash needed to bid on a house so the pool of bidders was much smaller than the size of the real estate investing public.

Jim, as a bidder, faced risks. One risk was that a close to full priced offer was made by someone else before the auction and that the offer was accepted by the bank. Another risk was that a higher bid was made by someone else at the auction. Either way, Jim would lose the property. Winning had its own risks. If Jim wasn't careful, he could pay more than the property was worth. There was also the risk that there were senior liens on the property or physical defects to the property.

Evaluating the Property

This foreclosure property could be a great opportunity or a disaster. Jim was well aware of the national and local housing markets but maybe it was time to buy. The Trenton Street house looked attractive. It was built in 1939 and had updated wiring and new energy efficient (low-E) windows throughout. The house also had a newer gas furnace. In October of 2006 a new loan was placed on the house for \$94,000. There was no multiple listing service (MLS) listing, so the house was likely sold for sale by owner and Jim guessed the down payment was probably around 10 percent. Therefore, the house was probably sold for about \$104,000 in October of 2006. The May 2008 listing price for this house was \$110,000. The selling real estate agent stated that the house must be sold for at least \$108,000 in order to cover all realtor and attorney fees and that the bank would not consider a short sale. From the outside the house appeared well cared for. The house had some negative features. There was only one bedroom and bathroom on the main floor. The other two bedrooms were in the basement where there was not a bathroom. The house had about 700 square feet on the main floor and 700 square feet in the basement. Because of the changing real estate market, and because this was a foreclosure, the market value of this house was not clear. Jim knew his job would be to estimate a reasonable price for the home. From finance and real estate books Jim knew there were two common ways to estimate the price of the house. The first was to estimate the cash flows and discount them by a reasonable interest rate. Jim knew his strategy should be to estimate cash flows for both normal and worst case scenarios. The second way was to find a comparable house, estimate its multiple and apply it to this house. In estimating multiples Jim would need to find houses that were as similar as possible to this house in terms of age, number of bathrooms and location, and he would need to estimate the price per square foot. Then, Jim could simply use their price per square foot as a multiple to times by the number of square feet of this property.

Cash Flow Estimates

While it would be great to have a crystal ball, Jim knew any expenses he used in his calculations were estimates. Jim was worried about needed repairs. A short tour of the house revealed that the last tenant was hard on it, destroying the bathroom fixtures. Presently, the tenant was evicted and the house sat vacant. If Jim bought the home, he would need to replace the bath fixtures at a cost of around \$1,000. The basement bedrooms needed egress windows to be used as a fire escape in the event of a fire. It cost \$1,500 to install each egress window. Jim needed to install

two windows, one for each bedroom. The house also needed cleaning and painting at a cost Jim estimated at \$1,000.

There were other cash flows to consider. Based on his experience with his other rental, Jim knew he could treat depreciation as an expense on his personal income taxes. Depreciation was an important component of cash flows because it reduced taxable income. Jim knew the IRS tax code would specify how he could depreciate a rental and that it would be based on the price Jim paid for the property plus improvements he made to it such as the bathroom fixtures. Jim thought \$50,000 was a good estimate for the tax basis for the house. Based on IRS publication 527, the house had a 27.5-year life and the annual percentage amount for depreciation was 3.636%.

Jim thought he could maintain and repair the house himself. Tenants shoveled snow and mowed at the rental he currently owned. Jim thought he'd require the same if he bought the new property. In a worst case scenario, if Jim hired snow removal and mowing it could cost as much as \$100 per month for four months of the year. Jim knew he could complete almost any repair but there were still the supplies and materials to buy to complete the job. After owning his other rental for over a year, Jim found costs ran around \$50 a month.

Taxes were another issue. Property taxes and income taxes were important. Based on his other rental, Jim estimated property taxes of \$1,900 per year and Jim thought this was a reasonable estimate for the future. Jim was somewhere between the 25% and 15% marginal tax bracket for his personal income and thought that both tax rates were good estimates over time. Jim expected he would be in the 15% tax bracket when he retired.

There would be other ongoing expenses for the house. Jim knew he needed to buy insurance if he successfully bid on the property. His other rental cost \$360 per year to insure so he decided to use that number.

It was clear that some cash inflows and outflows occurred each month while others were less frequent. Taxes and insurance were semi-annual expenses. However, to model the expenses Jim decided to estimate all expenses on a monthly basis. Jim knew it was important to correctly model all of the inflows and outflows.

There were many cash inflows to consider. The first was rent. Jim's rental generated \$700 per month and was rented to three graduate students. Each student paid \$233 per month. The students paid utilities. A realtor thought Jim didn't charge enough rent. The realtor thought Jim could charge each student \$250. Jim asked next door neighbors, who were student renters, what they paid and they said they paid \$250/month, but that included utilities. It was difficult to know what to charge because students were price sensitive. Jim was keenly aware at how price sensitive students were when he watched them willingly park four blocks away from campus for free off street parking rather than pay for a parking pass. He knew it would be difficult to charge

a lot, or to raise rents. Jim had the option of including utilities, but wasn't sure what would be the best strategy. While Jim thought he might be able to get \$700 per month and have the tenants pay utilities, in a worst case scenario he expected the house would sit vacant one month per year.

Jim planned to sell the house in 20 years when he retired and needed to include the estimated future selling price in his calculations. Jim thought a two percent per year estimate for appreciation in the value of the home was reasonable but he also worried the housing market could crash and the house might drop in value for several years. Jim thought the long run might be better for the housing market. A temporary downturn in housing was one thing, prices over 20 years were another. Estimating what the house might be worth in 20 years was especially daunting given that the two percent grow per year would have to be based on the purchase price of the house, and the purchase price was exactly what Jim was trying to estimate. To simplify his analysis Jim decided to use \$85,000 as a purchase price in estimating what the house would appreciate to when he sold it. He knew he might need to adjust this price as the facts became clearer, but figured this was a reasonable beginning. Jim thought the worst case would be appreciation of \$10,000 over the next 20 years.

Comparable Houses

Jim knew of a few other houses to which he could compare the Trenton Street house in estimating the price. A year earlier Jim paid \$125,000 for his rental and it was just one block away from the Trenton Street house. Jim's rental had 1,200 square feet on the main floor and 1,200 feet in the basement. It had two bedrooms and a bathroom upstairs and one bedroom and bathroom in the basement.

Jim researched the neighborhood market and found another house that recently went to foreclosure and was sold at auction for \$118,000. This foreclosure property was a bit further from the university but was also in the lower university neighborhood. It sold in May of 2002 for \$102,000 and again in May of 2005 for \$112,900. This property also had central air, a hot tub, sprinkler system and a newer roof which were all items the house Jim was looking at did not have. It had 1,072 feet of living space upstairs and 1,072 feet downstairs. It also had two bedrooms and one bath on the main floor and one bed and bath downstairs.

Other Concerns

In estimating the price of the foreclosure there were other issues that Jim tried to get a handle on. There really wasn't much buildable land close to the university which Jim saw as a plus. Also, in the long term, gas prices would likely only go higher. On the other hand, the city might develop mass transit in the future. If that happened the location close to the university might be less important. Also, while students were price sensitive, they were also time sensitive and may be willing to pay more if it meant they didn't have to drive to school and find a place to park.

Another concern was the rental history for properties in the lower university area. Jim's rental was fully rented to graduate students and had not needed cleaning or advertising for several years. Word of mouth made it so that as one student left another entered. The rental's location, close to campus, was perfect for students. That said, rents had not increased in two years and he didn't expect them to increase any time soon. Moreover, if Jim bought and rented the Trenton Street house to undergraduates he might end up with students that were hard on it, or turnover might be high. Undergraduates often expected to leave for the summer. Landlords worked out deals with good tenants and let them pay rent 11 out of 12 months. Tenants liked it and landlords liked the stability. It also saved the expense of listing and advertising.

Jim also wondered how accurate his resale estimates were. The foreclosure property was nice enough that it could be sold as a single family dwelling to a couple or a single buyer. Jim had the criterion that he would not own a property that he was not willing to live in and this property met this criterion. However, with just one bedroom on the main floor and the rest in the basement, and with only one bathroom it might be hard to sell the home to a family. The house was scheduled for a foreclosure auction in September of 2008, which meant Jim would miss the summer move-in season if he had a winning bid. Students wanted to rent before school started and it might be hard to rent the house in September. If this happened Jim would lose out on several months' rent and might have difficulty finding good tenants.

If Jim purchased the house he would have to pay cash because it was a foreclosure auction. Once purchased, Jim thought he might refinance this property, but wasn't sure. In any case, purchasing the house would require Jim to liquidate mutual funds he owned and move the money to the bank. Because the market was down, Jim was just as likely to have capital losses as capital gains, but, he did not want to miss out on any market increases. An unsuccessful bid would mean putting the money back into a mutual fund.

A successful bid would mean owning a rental instead of a financial asset. What would owning another rental yield as compared to a mutual fund? Jim wondered, "based on my estimates, what should I bid for that house or should I even bid at all?" Jim had estimated cash flows so he could develop a best and worst case scenario. Jim also had the prices of comparables but wasn't sure how reliable those cash flows and prices were.

The calculations and decision would also depend on the discount rate Jim used to find the present value of the future cash flows. Would it be better to use the borrowing rate which he estimated to be about 6.5% for an investment property with a 30 year fixed loan, or should he use the long-term average for large-cap mutual fund which was about 12%? The auction was coming up and it was time to get to work on the maximum price he would be willing to bid.

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TRAINING SESSION CONFLICT

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This critical incident was prepared by the authors and is intended to be used as a basis for class discussion. The views presented here are those of the authors and do not necessarily reflect the views of the Society for Case Research. The authors' views are based on their own professional judgment. The names of the organization, individuals, and locations have been disguised at the request of the organization.

Late in the evening on Wednesday, training coordinator Alan Brown sat in his room reviewing the events of the day. The training group he was responsible for had erupted that morning when one member confronted another about his earlier actions in the group. The confrontation had been quite direct and blunt, followed by other members of the group vociferously expressing both agreement and disagreement with the substance of the attack. Alan had had difficulty moving on with the planned agenda during the remainder of the morning and through the afternoon. The group, previously active and animated, had lost its momentum and become distracted and unable to focus, threatening to derail the entire training program. Now, he wasn't sure whether to raise the issue with the group again in the morning, and if so what to say, or to move on and let the issue die. He felt it was important to think through the situation and its effect on the group and make a decision as to how he would proceed.

The Setting

On a Sunday in July, a group of college and university instructors arrived at a remote coastal lodge and conference center near a small town in Oregon for a week-long training program. The focus of the training was to help participants learn how to increase student learning by integrating more student-centered cooperative learning methods into their courses. All of the participants stayed in on-site housing, ate their meals together in a dining area, participated in daily morning and afternoon training sessions, and socialized during the evenings at the training site or in the local town.

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Sunday Opening Session

At the opening session on Sunday evening, after some introductory comments from Alan, the training coordinator, all participants were asked to state their names and to share something about themselves. Most gave their names and university affiliations, and shared information about their hobbies and interests. When Paul's turn came, he took a little different approach, stating "My name is Paul. First, I would like to say that I am a Christian first and foremost; second, I am a family man with a wife and four wonderful daughters; and third, I am a teacher."

After the last participant had introduced herself, Paul raised his hand and was acknowledged by Alan, "Yes, Paul." Paul, who was at that time sitting in the first row, stood up and turned to address the class. He stated that he believed it was very important to remember names and indicated that he wanted to demonstrate a name recall technique to the class. Alan gave his approval, and Paul proceeded to recite the name of each of the 29 participants and trainers in the room. Paul did not merely state the name of each person but accentuated and dragged out the pronunciation as he went through the set of names. For example, rather than merely saying the name Matt, he would drag out the pronunciation as "Maatttt." In addition to the manner in which Paul articulated the names, he used accompanying hand gestures to provide added emphasis to the pronunciation. Despite the unusual verbal and nonverbal communication methods used by Paul, he successfully remembered and stated every person's name.

The participants appeared to be quite impressed with Paul's skill, and a few complimented him on his accomplishment. Paul offered to teach the class the technique at a later time during the conference if Alan and the trainees were interested. Alan was visibly pleased with Paul's ability to recall everyone's name, and he, too, stressed the importance of instructors learning students' names as quickly as possible. Alan informed Paul that he would work him into the training schedule the first thing on Wednesday morning.

Background

Paul had been in the military and now served as a university professor. He was approximately 35 years old and clean-cut in appearance, had short hair, dressed neatly, appeared athletic, sat up straight, was articulate, and had a youthful yet professional air about him. As one training participant put it, "Paul seems like a nice guy, a really decent sort of person." Paul seemed to have strong religious convictions. He had introduced himself as a Christian, and he prayed before each meal in the common dining room.

Kevin, another trainee, was also a university professor. He appeared to be a bit older than Paul and, though not out of shape, he was not as fit as Paul. Kevin seemed more the type who for recreation might hang out around the pool hall drinking beer, as evidenced by his spending more than a few evenings during the training week at a local bar. Kevin was hardly the altar boy type, as noted by one of the participants. He was somewhat irreverent, having quipped early on in the

training sessions, “I carry my feelings on my sleeves and I lead with my jaw. I often get myself into trouble. I am not one to sit around while an injustice unfolds. I will speak my mind regardless of who it might piss off.” Kevin had also shared with some of the trainees that he often angered many of his colleagues. Kevin joked, “I have a very special knack for ticking people off. I can’t help it. That’s just who I am.” Both Paul and Kevin were likeable enough, but other than their occupational similarities, they were two very different people from two very different backgrounds. Kevin had come from an economically disadvantaged background, while Paul had a more privileged upbringing.

Monday Evening

At dinner the next night on Monday, Paul walked by Kevin’s table. As soon as Paul was out of earshot, Kevin took the opportunity to mimic the way Paul had demonstrated the name recall method. Kevin put both of his arms out straight in front of him. He manipulated his index fingers on each hand as if to symbolize quote signs much as Paul had done and then parroted Paul’s enunciation of a few of the trainees’ names during the name recall exhibition. Smirking while he recited the names, he over accentuated the pronunciations used by Paul. Kevin pronounced Neeeenaaaa, Roberrrrrt, Andrewwww.” While Kevin mimicked Paul’s articulations, he thrust his hands to and fro in exaggeration of Paul’s hand/arm gestures. After this display, it was obvious that Kevin was very pleased with himself. Later, one of the trainees who had had dinner with Kevin recalled the incident. “It was obvious to me that Kevin had a problem with Paul. I was a little surprised that Kevin felt a need to make fun of Paul’s ability to recall everyone’s name. I didn’t have a problem with the way Paul recited the names.”

Wednesday Morning – Paul’s Presentation

Alan scheduled Paul to present the name recall technique on Wednesday morning. The group met in the training room, and Paul proudly discussed his method. He began by describing how impressed he had been in the military when a higher ranking officer remembered Paul’s name despite having hundreds of personnel under his command. Paul shared with the class that after that event he had prayed to be granted the ability to follow that officer’s example.

Paul went on to describe his techniques. “The first thing I do is to pray for God’s help, and I then focus on a person’s face. If I were to see you thirty years from now, I would always recognize your face. I don’t try to make associations like some name recallers do – it’s all in the face. Upon hearing someone’s name, I then rehearse that name in my mind.” Paul walked up to Jeff, one of the participants sitting in the first row, and extended his hand. “Hi, my name is Paul, and you are?” Jeff answered in kind, “Hi, I’m Jeff.” “Jeff. Hi, Jeff,” Paul articulated. Paul then continued to audibly rehearse Jeff’s name as he would do in his own mind in an actual situation. “Jefffff, Jefffff, Jefffff.” Paul moved on to the person sitting next to Jeff. “Hi, I am Paul, and you are?” “I am Bob,” the trainee responded. “Bawwwwwb. It’s nice to meet you, Bawwwwwb.” Paul again demonstrated his rehearsal method aloud, “Bawwwwwb, Bawwwwwb,” and then

“Jefffff, Bawwwwb, Jefffff, Bawwwwb, Jefffff” Paul moved on to a third trainee and continued the process.

After talking with the third trainee, Paul then reiterated the process for learning his name recalling technique. “First I pray. Then I focus on the face. I reassure myself that I can do it. I then rehearse each person’s name and then the growing sequence of names.” Paul again repeated the process: “I pray, I focus on the face, I instill self-confidence, I rehearse each name, and then I rehearse the sequence of names.” Paul then followed a technique he had learned from the training sessions. “Would someone please repeat the procedure for us?” One of the trainees volunteered and listed the steps given by Paul. At that point, Paul returned to his seat in the third row of the training room.

Kevin’s Response

Sitting at a table two rows behind Paul was Kevin. Kevin had been a very outspoken trainee during the first two days of the training. He was very direct and honest, often bluntly so. He had shared many of his own experiences and concerns throughout the program, even at the risk of alienating himself from others.

It was after Paul had returned to his seat that Kevin blurted out:

Paul, let me give you a little advice that I think will serve you well as a life-long lesson. You can’t come in here and push your religious views on us. You may be able to get away with that stuff at your university, but you had better be very careful with other groups. I was very offended by your approach. I am an atheist and I can learn your method without having to pray first. You had better stop pushing your religious views on the rest of us!

In response to Kevin’s outburst, the room became very quiet as others in the room looked at each other and avoided looking directly at either Kevin or Paul. Nobody said anything. Michael, one of the participants, later said he wondered at the time whether Kevin was actually acting out a role as part of the training since the assigned case reading for that morning had involved a difficult student in a classroom situation. Michael had wondered if he and his classmates were being duped, but did not have a lot of time to think about it.

Surprisingly, Paul managed to maintain his composure in the face of Kevin’s comments. After a short pause, Paul responded, “I don’t push religion in my classes. All I was doing was sharing with the class how I perform my name recalling method. It was not my intent to push anything on anyone. I think I can understand your position, Kevin, because I too used to be an atheist.” Kevin jumped right back in, “Listen Paul, you just can’t bring religion into a class the way you did. You have to respect the rights of your audience and students. You just can’t throw it into our faces that way.”

Before Paul could respond, Amanda, one of the other trainees interjected in a loud and emotional way, “I too was very offended. I am a person faith but I am not Christian. Are you telling me that I can’t learn this method without praying?” Before Paul had a chance to respond, Mary, another trainee, shared her perspective. “On the other hand, I was not offended. Paul merely shared with us how he learned names. If Paul’s procedure involves praying and we asked him to share his procedure, why shouldn’t he tell us praying is part of it?”

That was not the end of it. Next, Susan jumped in. “I was offended because Paul used this class to ‘force’ religion down our throats! I’m glad Kevin jumped in the way he did. Paul shouldn’t have used us that way and he needed to be stopped in his tracks. I think it is very inappropriate to use this forum to preach.” Looking over at Kevin, Susan said, “Thanks, Kevin.” A couple of other participants jumped into the debate, one of them supportive of Paul and the other on Kevin’s side.

It appeared to Alan that the session had really unraveled. He thought to himself, the class has worked so well together up until this point, with a lot of open and honest discussion--everyone seemed to like each other and they were working well together. All of that now seems to have gone by the wayside; all of a sudden all hell has broken loose. How long is this going to go on and how can I get the class back on track?

“We might as well call it a morning” one trainee whispered to the person next to her. Many of the trainees were looking toward their leader Alan as if to say, “Alan, do something about this; please, please do something!” After the debate had gone on for many minutes, Brandon, one of the other trainers, spoke saying, “Listen, we are getting off track here. We need to move on to the case discussion for the day.” At that point, Alan, spoke up: “We asked Paul to show us how he learned names and he did. I appreciate Paul doing that for us.” At that point, Tim, the trainer who was scheduled to go next, walked up to the front of the class and began asking questions about the assigned case. One trainee pointed out that the conflict situation that had just transpired could serve as a parallel to the text case they had all read.

Approximately ten minutes into the case discussion, Kevin spoke out. “I want to formally apologize to Paul in front of the entire class and admit that I was wrong and I shouldn’t have handled it the way I did. I should have spoken privately with Paul at break.” Despite Kevin’s statements, Paul did not turn around to look at Kevin or acknowledge in any way his acceptance of Kevin’s apology.

The ensuing discussion of the case was not very lively. The trainees seemed preoccupied with the preceding events and/or reluctant to actively participate. The discussion for the remainder of the morning and the rest of the day never reached the high levels attained on the previous days. At break, Kevin approached Paul and they carried on what appeared to be a civil conversation about the events that had unfolded. When later asked by the one of the trainees whether he and

Paul had managed to work it out, Kevin responded, “Oh yeah, I told Paul my goal was to help him. He seemed to understand.”

After the morning session during lunch, afternoon breaks, dinner, and into the evening, many of the trainees discussed the event of the day and shared with one another their thoughts and opinions about what had transpired. A few of the people who worked at the same university as Paul stated that they felt Paul appeared to be troubled and embarrassed by the incident. One stated, “Paul appears withdrawn and disinterested now.” One of Paul’s colleagues noted that he believed Paul needed something like this because Paul had “pushed the envelope” in sharing his religious views with co-workers and students. In contrast, another of Paul’s colleagues indicated he was very frustrated and angry with the way Paul was treated. “Paul was asked to share his method with the group and that is exactly what he did. Why should Paul have to take abuse when he was doing the group a favor?”

Alan’s Dilemma

Alan continued thinking about the day’s developments. The training program seemed to have lost its momentum. He wondered where his responsibilities lay. What could he do to get things back on track? He wasn’t sure whether to raise the issue with the group in the morning, and if so what to say, or to move on and let the issue die. He was also concerned with how Paul might be taking it all. He felt it was important to think the situation through and make a decision as to how he should proceed in the morning.

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WEIGHTED AVERAGE COST OF CAPITAL AT ROCKWELL COLLINS, INC.

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This critical incident was prepared by the authors, and is intended for use as a basis for class discussion. The views represented here are those of the critical incident authors and do not necessarily reflect the views of the Society for Case Research. Authors' views are based on their own professional judgments

In early 2005, Rockwell Collins, Inc. (Rockwell) was considering the acquisition of Teldix GmbH (Teldix) from defense contractor Northrop Grumman. The deal, valued at approximately \$100 million, would provide Rockwell an important opportunity to expand defense sales in the European market. (Dow Jones Newswires, 2005, p. 1) Identifying Rockwell's own Weighted Average Cost of Capital (WACC) may provide valuable information in determining an appropriate discount rate for the acquisition. As with any major capital expenditure project, identifying an appropriate discount rate could make the difference between generating and destroying significant amounts of shareholder value.

Company History

Rockwell owes its heritage to the Collins Radio Company, which was founded in 1933 by Arthur Collins in Cedar Rapids, Iowa. Collins Radio specialized in the development and manufacture of short wave radio equipment. Rockwell International, a large technology conglomerate, purchased Collins Radio in 1973. The company began operations in its current form on June 29, 2001 when Rockwell Collins, Inc. was spun off from Rockwell International.

Rockwell specialized in the design, production, marketing and support of electronic communications, avionics and in-flight entertainment systems for commercial, military and government clients internationally. Rockwell aviation equipment and electronics could be found in the aircraft of nearly every airline in the world and its military communications equipment was responsible for almost 70% of U.S. and allied military communications. The company operated in 60 locations in 27 countries and had approximately 17,100 employees. The company

was listed on the NYSE under the ticker symbol COL as of March 2007. (Yahoo! Finance, 2006).

Financial Highlights

Only ten weeks after Rockwell Collins was spun off from Rockwell International and became a publicly traded company, the events of 9/11 dealt a serious blow to the United States economy, especially the airline and aviation industries. As a result, Rockwell had a difficult first year of operation. For the fiscal year ended September 30, 2002, Rockwell Collins' total revenue decreased 11.4% to \$2.49 billion, with a small increase in government revenue partially offsetting a 21% decline in commercial revenue. (Rockwell Collins, 2002, p. 28)

Rockwell returned to positive sales growth in 2003 when revenues rose 2% to \$2.54 billion. This increase was the result of modest increases in government revenue due to increased defense spending in the aftermath of 9/11, offsetting another decline in commercial revenue, again due to significantly reduced demand in the commercial sector as airplane orders plummeted. (Rockwell Collins, 2004, pp. 25-26)

In fiscal 2004, revenues increased for the consolidated company, Government segment and Commercial segment by 15.3%, 20.9% and 9.7%, respectively. (Rockwell Collins, 2004, pp. 26-27) Total revenues were \$2.93 billion. This dramatic growth resulted from further increases in U.S. defense spending, international military spending increases, further diversification in the Commercial segment to include in-flight entertainment and business aircraft components, and a slight rebound in the international airline and aviation industries.

Net Income for the fiscal years ended September 30, 2002, 2003 and 2004 was \$236 million, \$258 million and \$301 million, respectively. These gains represented percent changes of 70%, 9% and 17%, respectively, over the previous fiscal years. (Rockwell Collins, 2004, p. 24) These financial results were, in part, responsible for Rockwell's impressive stock performance over the same time period. Table 1 summarizes Rockwell Collins consolidated financial performance for the years ended September 30, 2002, 2003 & 2004:

Table 1 – Summary Financial Highlights

(in millions)	2004	2003	2002
Sales	2,930	2,542	2,492
Net income	301	258	236
Stock price increase	52%	13%	56%

Sources: Rockwell Collins annual reports 2002 & 2004 and www.finance.google.com

Sources of Capital

When Rockwell Collins was spun off from Rockwell International in June 2001, each Rockwell International shareholder received one common share of Rockwell Collins stock for each common share of Rockwell International owned. (Rockwell Collins, 2001, p. 1) At the time of

the Teldix acquisition, Rockwell Collins was authorized to issue up to 1 billion shares of \$0.01 par value common stock. At the time of the acquisition there were approximately 183.8 million shares outstanding, which were trading in a range of \$45.00 to \$47.00 per share. (Yahoo! Finance, 2006) Rockwell's beta for the period from July 2001 through February 2004 was 0.842.

In November 2003, the company issued \$200 million of unsecured bonds expiring December 2013. The bonds carried a 4.75% coupon paid semi-annually. (Rockwell Collins, 2004, p. 46) At the time of the Teldix acquisition, the book value of the Rockwell bonds approximated fair value. (Rockwell Collins, 2005, p. 52)

Business Segments

Rockwell was divided into two main operating businesses: Government and Commercial. The Government segment provided defense communication and electronics products, including navigation and display systems, to the U.S. government, namely the U.S. Department of Defense, other U.S. civil agencies, international militaries and governments and other defense contractors. The performance of the Government segment over the past several years had been in part a result of increased U.S. defense spending. Furthermore, increases in specific sections of the U.S. defense budget had been targeted toward many areas that fall in line with Rockwell Collins' "core competencies and product offerings", namely communications and electronic systems. (Rockwell Collins, 2004, p. 25) The company expected defense spending by the U.S. and other nations to increase moderately over the next several years, and since these budgets were likely to focus on increasingly more technical and sophisticated equipment, demand for Rockwell's products would remain strong, according to the company's 2004 annual report. Key risks affecting this segment included the international geopolitical climate, the U.S. defense budget and specific allocation within this budget.

The second reporting segment of Rockwell Collins was the Commercial segment. This segment specialized in the manufacture and distribution of aviation electronics to customers around the world, including international airlines, original equipment manufacturers of airline components and airplanes and business jet operators. The Commercial segment struggled financially in fiscal 2002 and 2003, due largely to the downturn of the airline and aviation sectors. However, 2004 marked a turnaround in the fortunes of the airline industry and the Commercial segment. Increases in airline passenger traffic and better international economic conditions provided an opportunity for increased revenue and earnings growth. The service business within this segment enjoyed especially strong financial results as airlines looked to improve and update their fleets. Rockwell predicted that demand for new aircraft would rise in the coming years, as the airline industry's economic fortunes improved. The main risks affecting this segment were the actual recovery rate of the airline industry, oil prices and the segment's ability to meet and exceed its customers' demands. (Rockwell Collins, 2004, p. 26)

Rockwell segment financial information for the 2001 through 2004 fiscal years is included as Appendix A of this document.

Market Conditions

The historically volatile commercial aviation industry was in a state of significant upheaval after the terrorist attacks of September 11th, 2001. In the following years, a number of major airlines, including United, Delta, Northwest and US Airways, had declared bankruptcy due to lower levels of passenger traffic as well as rising fuel prices. Volatility in the airline industry had resulted in significant volatility in the demand for large commercial aircraft from major manufacturers Boeing and Airbus. In the year following the 9/11 terrorist attacks, orders for commercial aircraft fell over 50% from their pre-9/11 levels. (Standard & Poor, 2005, p. 2) By 2005, however, orders had rebounded dramatically with Airbus taking net orders for 1,055 planes while Boeing received net orders for 1,002 aircraft. This banner year for sales by both manufacturers was attributed to “torrid economic growth in China, a surge in the number of start-up airlines in India and vigorous expansion of airlines based in the Persian Gulf” according to the Wall Street Journal. (Stanley, 2006, p. A8) Volatility in the demand for commercial aircraft translated into volatility in the demand for the avionics supplied by Rockwell.

In sharp contrast to the volatile demand from the commercial aviation sector, demand for avionics from the defense industry was much more steady and predictable. Data from the U.S. Department of Defense, which accounts for 40% of global defense spending, demonstrated the stability of defense spending. (Standard & Poor, 2005, p. 4) In the period from 1990 to 2006, year-to-year Department of Defense spending changed by more than 10% only twice, in 2002 and 2003 due to the conflicts in Afghanistan and Iraq. (Standard & Poor, 2005, p. 12)

Industry Participants

Appendix B provides information regarding the common stock beta for Rockwell, a number of other defense contractors and a number of US based commercial airlines. This information demonstrates the risk profiles of the commercial aviation and defense sectors.

Market Conditions

The historically volatile commercial aviation industry was in a state of significant upheaval after the terrorist attacks of September 11th, 2001. In the following years, a number of major airlines, including United, Delta, Northwest and US Airways, had declared bankruptcy due to lower levels of passenger traffic as well as rising fuel prices. Volatility in the airline industry had resulted in significant volatility in the demand for large commercial aircraft from major manufacturers Boeing and Airbus. In the year following the 9/11 terrorist attacks, orders for commercial aircraft fell over 50% from their pre-9/11 levels. (Standard & Poor, 2005, p. 2) By 2005, however, orders had rebounded dramatically with Airbus taking net orders for 1,055 planes while Boeing received net orders for 1,002 aircraft. This banner year for sales by both manufacturers was attributed to “torrid economic growth in China, a surge in the number of start-up airlines in India and vigorous expansion of airlines based in the Persian Gulf” according to the Wall Street Journal. (Stanley, 2006, p. A8) Volatility in the demand for commercial aircraft translated into volatility in the demand for the avionics supplied by Rockwell.

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Industry Participants

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Other Information for WACC Calculation

Appendix C, which may be provided at the discretion of the instructor, contains additional information that may be helpful in calculating Rockwell's Weighted Average Cost of Capital. The information in Appendix C includes the following: market risk premium, risk free rate, and Rockwell's effective tax rate. If not provided by the instructor, this information may be gathered from a number of other sources including textbooks and the internet.

The market risk premium is the additional return investors received for investing in equity securities (typically the S&P 500 index) as compared to the risk free rate of return (typically 13-week treasury securities). Most undergraduate finance textbooks define the market risk premium and provide an estimated market risk premium based upon historical returns for the S&P 500 and 13-week Treasury Bills. As there has been considerable debate in academe regarding the appropriate approach to measure the market risk premium, a number of authoritative web resources are also available to provide estimates of the market risk premium.

The risk free rate represents the minimum return received by investors in exchange for delaying consumption. The risk free rate is typically measured by 13-week Treasury Bills. The United States Department of the Treasury Office of Debt Management has maintained a set of historical Interest Rate Statistics on their web-site (www.ustreas.gov). A variety of other web resources are also available to provide estimates of the risk-free rate. The most significant debate in academe around the risk free rate has been whether a current Treasury Bill rate or long-term average of Treasury Bill rates should be used in the WACC calculation. Rockwell's effective tax rate at the time of the acquisition was approximately 30%.

Transaction Description

In completing the Teldix acquisition, Rockwell would increase their European employee base by approximately 40%. With revenues of approximately \$90 million in 2004, Teldix was a leading provider of military avionics and related services in the European market. Providing avionics for cockpit management, mission management, missile control, defensive aids, and interface

management as well as other electronic components for military application, Teldix provided an important strategic opportunity for Rockwell to advance its position in the European defense market. (Teldix GmbH, 2006)

While acquisitions are more complex than many capital investment opportunities, the cash flows associated with this capital expenditure must be discounted to their present value to determine if Teldix would generate value for Rockwell's shareholders. The challenge here then is to calculate an appropriate discount rate for Rockwell to use in valuing this important capital investment opportunity based upon the limited information available.

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Appendix A – Segment Information

Segment Information

PARTIAL INCOME STATEMENT	Year ended September 30			
	2004	2003	2002	2001
Sales:				
Government Systems	1,535	1,270	1,115	1,068
Commercial Systems	1,395	1,272	1,377	1,752
Total sales	<u>2,930</u>	<u>2,542</u>	<u>2,492</u>	<u>2,820</u>
Segment operating earnings				
Government Systems	282	250	193	165
Commercial Systems	200	137	174	275
Total segment operating earnings	<u>482</u>	<u>387</u>	<u>367</u>	<u>440</u>
PARTIAL BALANCE SHEET	September 30			
	2004	2003	2002	2001
Identifiable assets:				
Government Systems	1,057	823	822	785
Commercial Systems	1,290	1,278	1,334	1,402
Corporate	527	490	404	450
Total identifiable assets	<u>2,874</u>	<u>2,591</u>	<u>2,560</u>	<u>2,637</u>
Depreciation and amortization:				
Government Systems	45	38	34	45
Commercial Systems	64	67	71	93
Total depreciation and amortization	<u>109</u>	<u>105</u>	<u>105</u>	<u>138</u>
PARTIAL CASH FLOWS	September 30			
	2004	2003	2002	2001
Capital expenditures for property:				
Government Systems	43	32	23	40
Commercial Systems	51	40	39	70
Total capital expenditures for property	<u>94</u>	<u>72</u>	<u>62</u>	<u>110</u>

Source: 2004 and 2002 Rockwell Collins, Inc. annual reports

Appendix B – Information on Industry Participants

Defense Contractors

Company	Defense Revenues as % of Total Revenue	Common Stock Beta
Alliant Techsystems	89.8%	.399
Honeywell	40.0%	1.289
General Dynamics	78.2%	.539
L-3 Communications	88.9%	.521
Lockheed Martin	95.8%	.409
Rockwell Collins	58.9%	.842

Sources: Defense revenues as % of total revenues from *S&P Industry Surveys: Aerospace & Defense*, November 3, 2005, page 7 & Common Stock Betas calculated by authors using daily price data for each stock and the S&P 500 from <http://finance.yahoo.com> for the period July 3, 2001 to March 1, 2005.

Commercial Airlines

Company	Common Stock Beta
American Airlines	2.250
Continental Airlines	2.237
Southwest Airlines	1.173

Sources: Common Stock Betas calculated by authors using daily price data for each stock and the S&P 500 from <http://finance.yahoo.com> for the period July 3, 2001 to March 1, 2005.

Note: Beta calculations are not available for a number of major airlines including Delta, Northwest, United, and US Airways due to their bankruptcy filings during the period in question.

Appendix C – Additional Information for WACC Calculation

Note: Appendix C to be provided at the discretion of the instructor

Other Information

Estimated Market Risk Premium	5.6%
March 3, 2005 20-year US Treasury bill yield	4.82%
Rockwell's Effective Tax Rate, 2004 Actual	30.0%

Sources: Keown, Petty, Martin & Scott, Jr., 2006, p. 180 and
Daily Treasury Yield Curve Rates, 2006

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