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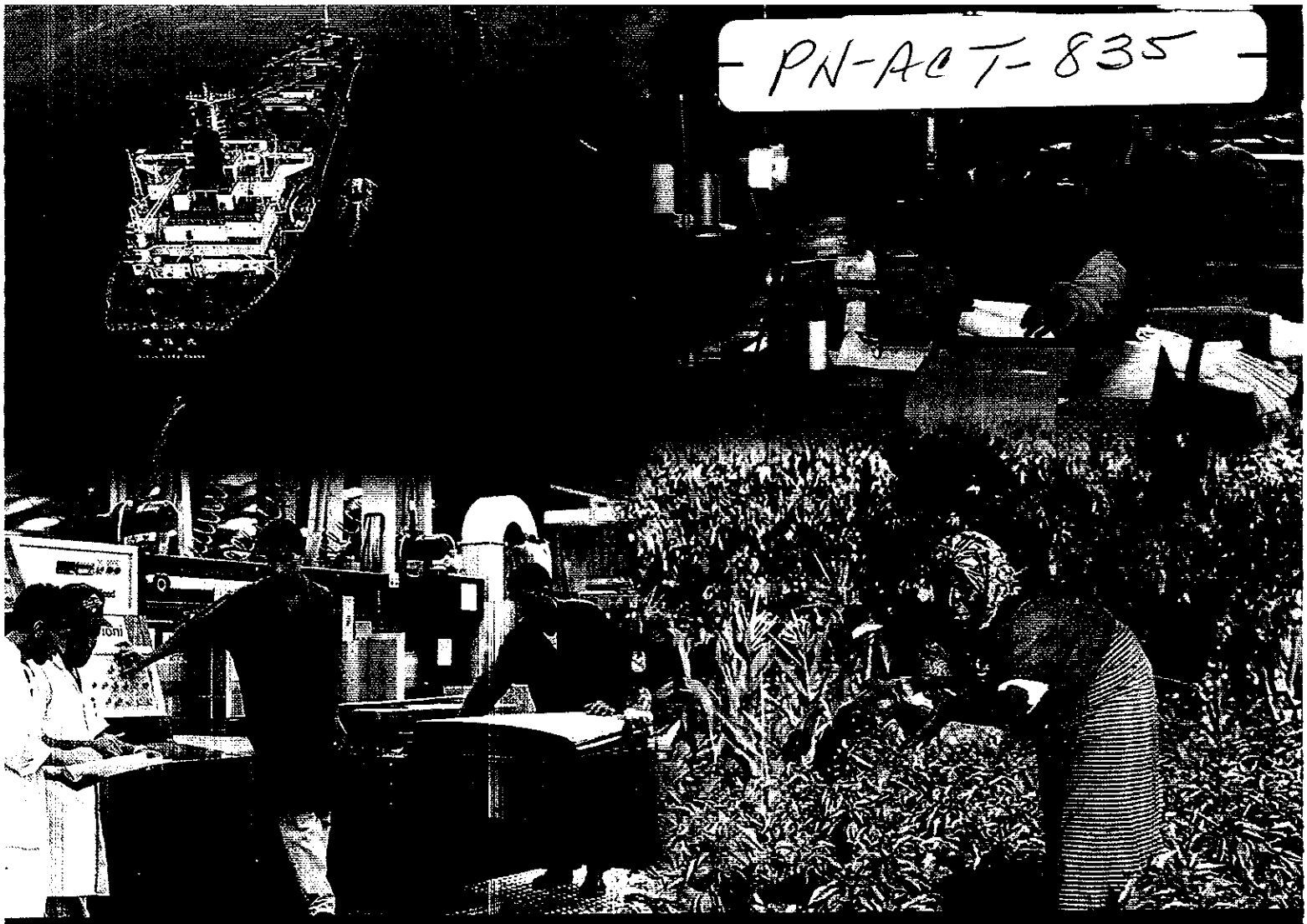

Portraits of Business Practices in Emerging Markets

Cases for Management Education

U.S. Agency for International Development · Institute of International Education · R[illegible]

Portraits of

Business Practices

in

Emerging Markets

Volume 2

CASES FOR MANAGEMENT EDUCATION

Richard G. Linowes
Editor

INSTITUTE OF INTERNATIONAL EDUCATION, AND U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

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"Never doubt that a small group of dedicated individuals can change the world . . . indeed, it is the only thing that ever has." ~ Margaret Meade

For his guidance, vision, inspiration, and commitment to the FMDAP Advisers, this volume of the FMDAP casebook is dedicated to

Russell D. Anderson

Director, Office of Emerging Markets,
Bureau for Global Programs, Field Support and Research
United States Agency for International Development.

He has contributed time and talent to furthering sustainable development and international cooperation throughout his career.

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A separate volume of Teaching Notes is available to support the classroom use of these cases.

Foreword

The publication and distribution of this second volume of case studies marks another milestone in the progress achieved by the Free Market Development Advisers Program (FMDAP). FMDAP has evolved since the first volume of case studies was created and published in 1994. Initially developed as a cooperative venture between the U.S. Agency for International Development (USAID) and the Institute of International Education (IIE) to serve small and medium-size private companies, FMDAP has increasingly benefited institutions, non-governmental organizations and business serving associations in emerging market nations. The impact of each Adviser's contributions has been broadened and the beneficiary pool widened to serve multiple organizations and managers.

For the past 80 years IIE has sought opportunities to foster leadership development and mutual understanding among university students and young professionals in the United States and abroad. Together IIE and USAID plan to enhance sustainable development abroad through assistance to small- and medium-sized businesses and microfinance institutions in basic management activities implemented through a long-term consultancy. For the U.S. participants, we worked to create an approach through which they could develop skills and strategies to succeed in a variety of situations, while applying principles and management practices acquired in their U.S. programs. Additionally, IIE and USAID look to the Advisers and their U.S. faculty mentors to work together in developing awareness in U.S. business schools about working in emerging markets. The case studies and accompanying teaching notes are meant to assist in this effort.

Beyond the realms of business and commerce, finance and trade, Advisers have played key roles in national development, regional peace process initiatives and institutional capacity building to serve a wide community of interests. The Advisers themselves have completed their academic programs and now are employed in the public service, corporate, development and education sectors. While acknowledging the fundamental contributions of our partners at USAID/Washington and USAID Missions around the world and our staff at IIE's Washington FMDAP program office, IIE's leadership commends first and foremost the 94 Advisers who have worked so hard and performed so well over the course of the last seven years.

The Advisers are a diverse group drawn from 53 institutions across the country and as a whole represent perhaps the strongest cadre of professional participants IIE has fielded in its history. All of us are gratified that our recruitment efforts and the potential of FMDAP have attracted a rich body of talent drawn from all communities in the U.S.

This volume contains the most emblematic of the case studies prepared by Advisers between 1994 and 1996; it was a difficult task for the editor and staff to choose the cases to be represented in this publication, but the results speak for themselves. Dr. Richard Linowes has guided the development of a document that accurately conveys the program's accomplishments in a lucid and consistent way. All of us are indebted to him for the patience and skill with which he has represented the efforts of our partnership.

This program would not have succeeded without consistent support from across the spectrum at USAID. My colleagues at IIE Leslie Anderson, Candida Mannozzi, Mark Grace and I want to thank our partners at USAID, especially John Wilkinson, Russell Anderson, Kenneth Lanza, Joe Carroll, Bruno Cornelio, Jason Matechak, Grant Morrill, as well as their USAID Mission colleagues in Bolivia, Zimbabwe, South Africa, Madagascar, Nepal, Morocco, Russia and Ghana.

Thomas Farrell
Vice President
Exchange Programs and Regional Services
Institute of International Education
Washington, DC

August 1999

Introduction

Richard Linowes, Editor

This volume is the second set of cases produced by the Free Market Development Advisers Program designed to enrich management education by teaching people about business life in the developing world. Drawing upon the project experience of 14 MBA students assigned to work overseas as advisers to business, these cases provide rich, eye-opening portraits of the realities of the social, political and management environment of business in eight developing countries. They expose today's students and professionals to the challenges of doing business in these parts of the world and help them understand the special skills and insights required to operate there effectively.

The Free Market Development Advisers Program, or FMDAP, is an innovative, well-conceived and conscientiously implemented partnership between USAID's Emerging Markets group and the Institute of International Education (IIE). Now in its fifth year of operation, it annually sends a select group of American-citizen MBA students midway through their graduate programs to ten-month internships in developing countries. There they work full-time helping clients address management challenges, such as launching a marketing campaign, producing a trade show or studying ways to control production costs. Project assignments draw upon the students' formal MBA training, their prior management experience and their American "can do" spirit. USAID in-country professionals and their host organizations expect them to make substantial contributions to the business during their time abroad.

At this publication, five adviser groups have been selected and sent overseas. Typically 11-15 advisers are sent each year. The first group of participants (overseas 1992-93) wrote the 16 cases that appeared in the first casebook (Volume 1) published several years ago.[1] This casebook (Volume 2) is the collective product of 14 members of the second and third classes who served overseas during the academic years 1994-95 or 1995-96. Advisers from those years whose work does not appear here may yet produce a case for publication in a subsequent volume. Developing world organizations assisted by this program were local small businesses, NGO-supported nonprofit organizations, government-sponsored small business development centers and some major accounting/consulting firms.

The Cases

This second volume of cases contains 14 cases, ten from Africa and one each from South America, Eastern Europe, and South Asia. Countries represented are Bolivia, Russia, Nepal, as well as the African nations Morocco, Ghana, Zimbabwe, South Africa, and Madagascar. Though all cases are in English, only three of the eight countries actually use English as their primary language in commercial and everyday dealings.

The cases take the reader inside several different industries. Some portray financial companies (a savings institution in Madagascar, a finance firm in Nepal, and a microcredit organization in Bolivia). Others examine the export of agricultural products (olives and capers and peppers in Morocco, pineapples in Ghana, and spices in Madagascar), while others propose processing of agricultural products (lumber milling in Ghana, and potato chip manufacturing in Russia). One case portrays a business involved in transportation (commuter transit in Zimbabwe) and another food retailing (a bakery in Nepal). Three describe companies engaged in manufacturing (corrugated boxes in Morocco, upholstered furniture in South Africa, and weaving in Zimbabwe), and one examines the government's proposed business development centers in South Africa.

It is informative to consider also the maturity of the enterprises under analysis. Half are established firms that have been in business for quite some time (offering microcredit in Bolivia, selling baked goods in Nepal, exporting of olives and capers and peppers in Morocco, manufacturing of corrugated boxes in Morocco, providing commuter transit service in Zimbabwe, offering personal savings vehicles in Madagascar, and manufacturing of upholstered furniture in South Africa). Two are diversifying firms actively expanding their horizons into businesses not previously part of their operation (beginning lumber milling in Ghana, and exporting spices from Madagascar). Two are fledgling firms (growing pineapples for export in Ghana, and financial services in Nepal) whose survival is in jeopardy, and three are proposed firms not yet up and running (producing potato chips in Russia, textile weaving in Zimbabwe, and new business development centers in South Africa).

Some readers might take interest in the nature of ownership of organizations portrayed in the cases. Four are family-owned businesses (exporting olives and capers

and peppers in Morocco, manufacturing corrugated boxes in Morocco, manufacturing upholstered furniture in South Africa, and providing commuter transit in Zimbabwe). Two focus on the overseas initiatives of large American companies (selling American lumber milling equipment in Ghana, and finding spices in Madagascar for an American food company).

Insights into business life in these countries were garnered largely through the in-country work experiences of the case authors. Their assignments furnished them with important grounding experiences and gave them personal appreciation for the issues and frustrations of cross-cultural encounter. Sometimes those work assignments became the focus of the case. In about half the cases, an American consultant, salesman or financier is an important figure in the storyline, and cross-cultural dealings are likely to surface in a rich classroom discussion (offering microfinance in Bolivia, exporting olives and capers and peppers in Morocco, selling timber equipment in Ghana, exploring for spice exports from Madagascar, manufacturing upholstered furniture in South Africa, and launching business development centers in South Africa). A British protagonist is the key Westerner in two additional cases (producing potato chips in Russia, and growing pineapples for export in Ghana). Other cases draw on the tangible experiences of the advisers, though the actual storyline in the case may constitute a quasi-fictional melange of separate events and distinct experiences.

Administration of the FMDAP Program

MBA participants began the program with an orientation session in Washington, DC a few weeks before they moved overseas. There they met with USAID and embassy officials and members of the international development community. [Orientation sessions for the two classes were somewhat different in scheduling and content.] Advisers were briefed about the economic and health issues of their region of the world and were trained in cross-cultural relations. They also met a few former participants of the program who had now returned to the United States. They also participated in in-depth case writing sessions led by the casebook editor in which they examined critically their experience to-date with cases in business school classes, and they firmed their views regarding curricular needs for developing world educational materials. Participants were encouraged to use their upcoming FMDAP work and living experiences to create new teaching materials that "plug the holes" they identified in the business school curriculum.

Once on the ground in their overseas assignments, advisers immersed themselves in their tasks. Periodically, they corresponded with the editor of this volume and their university mentors regarding potential case topics, and eventually a case idea emerged. Case drafts were revised extensively, orchestrated through the give-and-take review process with this editor and in some cases their university mentor. When advisers returned to the United States after completing their ten month assignments to take up their second year of graduate study, many had in hand a working version of a case. Participants benefitted from a weekend debriefing in Washington, DC during the fall following their return. During that session considerable work was done refocusing, refining, and enriching the case as well as defining standards and developing ideas for the case teaching notes. Over the ensuing months, students re-immersed themselves in graduate study; and most went on to graduate and join the professional work world. Despite these distractions, the case writing effort still demanded their attention, and in response to periodic calls from the editor the final version took shape. Generally, the editor played a strong role shaping the structure and content of the work, but the authors continued to make a yeoman's effort to improve the product.

The finished cases stand on their own as an important contribution to our general understanding of business life in the developing world. Most have been used at least once in my classes at American University, where they have never failed to generate considerably animated discussion. A large number were also used in a special one-time semester-long course on African business taught at Georgetown University during the spring of 1998. The cases all provide substantial background on the business setting in question, so they can all be used for more than one course in the business school curriculum. In general, students from developing countries find the cases a welcome relief to the teaching materials set in G-7 countries that dominate the curriculum. Students from developed countries are fascinated and often rattled by the challenges of conducting business in developing countries which they usually first learn about through the cases. On the whole, the cases have gone a long way towards creating a more savvy group of business graduates — people with a wider eye on business opportunities world-wide and more sensitivity to the fact that their customary ways may not be most effective in developing world settings. The cases are also a vehicle for building greater mutual respect between U.S. and international classmates within the business school student community.

The editor, case authors, program administrators and sponsors of the FMDAP program all hope that these cases prove useful to you, your students and/or your staff and colleagues in building awareness and comfort

level with the substantial challenges of doing business in developing countries around the world. The driving vision throughout the case development process was to see faculty, students and other interested parties develop a more enlightened, enthusiastic and realistic appreciation for the prospects of commercial ventures in the developing world. If even a small percentage of people sensitized by study of these educational materials choose to take initiatives to pursue economic opportunities in these parts of the world, then international firms offering needed goods and services will more effectively reach the global marketplace, and the substantial percentage of humanity currently living in the developing world will see substantial improvements in their living standards and economic lot.

Richard Linowes
Gaithersburg, MD
June 22, 1998

1 Richard G. Linowes (Ed.), *Portraits of Small Business from the Developing World, Volume* 1 (Washington, DC: Institute of International Education, 1993).

GEOGRAPHIC SETTINGS FOR THE CASES

COUNTRY	*INDUSTRY*	*CASE NAME*	*AUTHOR*	*INSTITUTIONAL AFFILIATION*
AMERICA				
Bolivia:	microcredit finance	**FIE**	Michael Aguilera	University of Washington
EUROPE				
Russia:	potato chip production	**Troika Potato Chips**	Gene Gutenberg	Cornell University
AFRICA				
Ghana:	pineapple exporting lumber equipment	**Aprobe, Ltd.** **TuTuff Equipment in Ghana**	Nita Eckert Christopher Shyers	University of Illinois Thunderbird
Madagascar:	banking spices	**Caisse d'Epargne (CEM)** **Frank Davis Comes to Madagascar**	Eileen McKeough Valerie VinCola	Yale University Emory University
Morocco:	corrugated packaging agricultural exporting	**Box-It** **ZATON**	John Rountree Shawn Cochran	University of Wisconsin University of Connecticut
South Africa:	small business centers	**Business Development Services**	Nicole Scheps	Rutgers University
	furniture manufacturing	**Sithole Upholsterers**	Hunter Moore	Texas A&M University
Zimbabwe:	business partnerships diversified family business	**CZI** **ETM Enterprises**	Kenneth Meagor Michael Eber	Monterey Institute Willamette University
ASIA				
Nepal:	banking	**Growing Pains**	Catherine Rothenberger	Thunderbird
	baked goods	**Hot Breads**	Julia Kreisinger	University of Massachusetts

PRINCIPAL THEMES FEATURED IN THE CASES

CASE	THEME	COUNTRY
Aprobe, Ltd.	Launching an agribusiness venture	Ghana
Box-It	Father-son debate on controlling costs	Morocco
Business Development Services	Dealing with racial/gender discrimination	South Africa
Caisse d'Epargne	Transforming a savings institution	Madagascar
Confederation of Zimbabwe Industries	Linking white- and black-owned businesses	Zimbabwe
ETM Enterprises	Financing a black-owned business	Zimbabwe
FIE	A micro finance firm in transition	Bolivia
Frank Davis Comes to Madagascar	An American sizes up business opportunities	Madagascar
Growing Pains	Financial firm in an emerging financial market	Nepal
Hot Breads	A bakery's staffing in caste-conscious societies	Nepal
ZATON	Food exporter growing beyond control	Morocco
Sithole Upholsterers	Family business learns professional management	South Africa
Troika Potato Chips	Sizing up a business plan for a proposed venture	Russia
TuTuff Equipment in Ghana	Launching export of lumber equipment to Africa	Ghana

SUGGESTED COURSE CONSIDERATION

All cases have primary themes and subthemes that make them useful vehicles for discussing a variety of issues of importance to management education, and that shed light on the challenges of running businesses in the developing world. The following list offers guidance to faculty members from various disciplines to help them "mine" this volume to find cases of potential interest for classroom use.

All cases are applicable to courses in Small Business Management or International Business. Beyond that, the cases named below may be suitable for pedagogical use in the following business school courses:

ACCOUNTING		
Box-It	Pricing without knowing costs	Morocco
Growing Pains	Honesty in financial reporting	Nepal
Sithole Upholsterers	Insights from activity-based costing	South Africa
BUSINESS-GOVERNMENT RELATIONS		
Aprobe	Surviving changes in government	Ghana
Business Development Svcs.	Government support for small business	South Africa
Caisse d'Epargne	Privatizing a savings institution	Madagascar
Confed. Zimbabwe Industry	Government condemning big business	Zimbabwe
FIE	Regulating the banking industry	Bolivia
Frank Davis	Securing government approvals	Madagascar
Growing Pains	Beginning private sector finance	Nepal
BUSINESS AND SOCIETY		
Business Development Svcs.	Helping the underclass succeed	South Africa
Caisse d'Epargne	Transforming a government agency	Madagascar
Confed. Zimbabwe Industry	Correcting the wrongs of yesteryear	Zimbabwe
FIE	Financing enterprises owned by the poor	Bolivia
Frank Davis	Attracting investment to spur development	Madagascar
Growing Pains	Introducing financial markets into society	Nepal
Hot Breads	Employing a caste-conscious work force	Nepal
ZATON	Working with an ample supply of workers	Morocco
ECONOMIC DEVELOPMENT		
Aprobe	The motives and conduct of entrepreneurs	Ghana
Business Development Svcs.	Opening centers to assist small business	South Africa
Caisse d'Epargne	Making credit more widely available	Madagascar
Confed. Zimbabwe Industry	Large industry helping small business	Zimbabwe
FIE	Financing entrepreneurship among the poor	Bolivia
Frank Davis	Exploring U.S. investment to begin export	Madagascar
Growing Pains	New financial firms in an emerging market	Nepal
ZATON	Running an export business to create jobs	Morocco
ENTREPRENEURSHIP		
Aprobe	Launching a pineapple export venture	Ghana
Box-It	Father and son debate business direction	Morocco
Business Development Svcs.	Licensing business development centers	South Africa
Confed. Zimbabwe Industries	Concocting an enterprise to create jobs	Zimbabwe
ETM Enterprises	Large bank lending to small business	Zimbabwe
FIE	Financing micro-enterprise	Bolivia
Frank Davis	Sizing up opportunities for exporting spices	Madagascar
Growing Pains	Growing a new finance company	Nepal
Hot Breads	Operating a franchise bakery	Nepal
ZATON	Family managers stretched too thin	Morocco

Sithole Upholsterers	Learning real costs in a family business	South Africa
Troika Potato Chips	Business plan assessed by a U.K. investor	Russia
TuTuff Equipment in Ghana	Deal-making to sell U.S. equipment	Ghana
FINANCE		
Caisse d'Epargne	Turning postal savings (PTT) into a bank	Madagascar
ETM Enterprises	Big bank begins small business lending	Zimbabwe
FIE	Micro-credit organization weighs its future	Bolivia
Growing Pains	First private finance firm struggles to grow	Nepal
Troika Potato Chips	Venture seeks financing to get launched	Russia
TuTuff Equipment in Ghana	Third party financing for sale of equipment	Ghana
INFORMATION SYSTEMS		
Box-It	Reworking data for activity-based costing	Morocco
Caisse d'Epargne	Replacing paper records with networking	Madagascar
ETM Enterprises	Pulling together financials into a report	Zimbabwe
FIE	Tracking regional performance of loans	Bolivia
Sithole Upholsterers	Discovering real costs of production	South Africa
INTERNATIONAL ECONOMY		
Aprobe	Growing pineapples for export to Europe	Ghana
FIE	NGO support for development	Bolivia
Frank Davis	Considering an American investment	Madagascar
Hot Breads	Franchising an Indian bakery in Nepal	Nepal
ZATON	Selling foods to Europe and the U.S.	Morocco
Troika Potato Chips	Venture seeking a British investment	Russia
TuTuff Equipment in Ghana	Deal-making to sell U.S. equipment	Ghana
MARKETING		
Aprobe	Getting produce to market	Ghana
Box-It	Pricing with poor knowledge of costs	Morocco
Business Development Svcs.	Promoting small business support services	South Africa
Caisse d'Epargne	Transforming a bank's customer service	Madagascar
Confed Zimbabwe Industries	Promoting black-white business linkages	Zimbabwe
Frank Davis	Scouting opportunities for export of spices	Madagascar
Growing Pains	Managing investor relations	Nepal
Hot Breads	Constraining the growth of competition	Nepal
ZATON	Managing overseas customer relations	Morocco
Sithole Upholsterers	Developing a market identity	South Africa
TuTuff Equipment in Ghana	Getting a toe hold in Africa	Ghana
NEGOTIATION		
Aprobe	Exploring whether to maintain a partnership	Ghana
Confed. Zimbabwe Industries	Setting terms for creating a new business	Zimbabwe
ETM Enterprises	Defining conditions for extending a loan	Zimbabwe
Growing Pains	Public disclosure and investor relations	South Africa
TuTuff Equipment in Ghana	A seller, buyer, and financier consider a deal	Ghana
OPERATIONS MANAGEMENT		
Aprobe	Distributing disappointing crop yields	Ghana
Box-It	Considering backward integration	Morocco
Business Development Svcs.	Support service needs across racial groups	South Africa
Caisse d'Epargne	Creating an organizational transformation	Madagascar
Confed. Zimbabwe Industries	Reviving old equipment to create jobs	Zimbabwe
ETM Enterprises	Establishing management controls	Zimbabwe
Frank Davis	Exploring a new source of supply	Madagascar
Hot Breads	Producing when understaffed by bakers	Nepal
ZATON	Unskilled jobs and crisis management	Morocco

Sithole Upholsterers	Furniture production in a family business	South Africa
Troika Potato Chips	Proposed venture of three linked institutions	Russia
TuTuff Equipment in Ghana	Purchasing equipment to begin operations	Ghana
ORGANIZATIONAL BEHAVIOR		
Aprobe	British ex-pat and local farmer share dreams	Ghana
Box-It	Father and son conflict over expansion plan	Morocco
Business Development Svcs.	Experiencing racial / gender discrimination	South Africa
Caisse d'Epargne	An authoritarian transforms an institution	Madagascar
Confed Zimbabwe Industries	Businessmen debate ties to small black firms	Zimbabwe
ETM Enterprises	Banker gives first new loan to her cousins	Zimbabwe
FIE	Debating organizational transformation.	Bolivia
Frank Davis	Navigating a foreign cultural environment	Madagascar
Growing Pains	Face-saving in a new financial firm	Nepal
Hot Breads	Caste / national factors affecting staffing	Nepal
ZATON	Cross-cultural mishandling of food exports	Morocco
Sithole Upholsterers	Professionalism/succession in a family business	South Africa
Troika Potato Chips	Dealing with Russian-style entrepreneurs	Russia
TuTuff Equipment in Ghana	American, British, and Ghanaian do a deal	Ghana
STRATEGY		
Aprobe	Assessing agribusiness prospects	Ghana
Box-It	Backward integration to control costs	Morocco
Business Development Svcs.	Requiring centers to think strategically	South Africa
Caisse d'Epargne	Transforming postal savings into a bank	Madagascar
Confed Zimbabwe Industries	Creating employment for social change	Zimbabwe
ETM Enterprises	New bank lending to black-owned business	Zimbabwe
FIE	Choosing institutional form for microfinance	Bolivia
Frank Davis	Exploring a new source of supply of spices	Madagascar
Growing Pains	Communicating to build public confidence	Nepal
Hot Breads	Insuring staff levels to meet demand	Nepal
ZATON	Growing uncontrollably without delegation	Morocco
Sithole Upholsterers	Controlling costs and developing an identity	South Africa
Troika Potato Chips	Proposing a venture to produce food locally	Russia
TuTuff Equipment in Ghana	Finding third party financing to make a sale	Ghana

CASE ABSTRACTS

Shown in alphabetical order by case name, with country of operation and suggested use in courses

APROBE, LTD. (Ghana) is a one year old venture that grows pineapples for export. Formed by a well-connected local businessman and a British ex-patriate looking for his big break, the venture fizzles as crop yields prove disappointing due to lack of rain. The two men huddle over what to do with this year's crop which is still shriveled in the field and revisit their motives for starting the business and their aspirations for its future.

[Business-Government Relations, Economic Development, Entrepreneurship, International Economy, Marketing, Negotiation, Operations Management, Organizational Behavior, Strategy]

BOX-IT (Morocco), a manufacturer of corrugated boxes, has just lost its largest customer because its prices are too high. The owners, father and son, debate whether to backward integrate to reduce costs and perhaps serve the son's ambitions, but then a new activity-based costing system shows that they can reduce prices and still cover costs.

[Accounting, Entrepreneurship, Information Systems, Marketing, Negotiation, Operations Management, Organizational Behavior, Strategy]

BUSINESS DEVELOPMENT SERVICES (South Africa) describes the roll out of a government program to create business advisory centers around the country to assist small businesses. The accreditation team travels to all regions of the country to select those offices that will serve as official centers for the program. The team encounters some racial and gender discrimination along the way. Once the centers are licensed, the team must standardize operations and build public awareness of the services provided.

[Business-Government Relations, Business and Society, Economic Development, Entrepreneurship, Marketing, Operations Management, Organizational Behavior, Strategy]

CAISSE D'EPARGNE (CEM) (Madagascar) is a government-run savings institution that is transforming itself into a bank. Immense progress has been achieved to-date in terms of upgrading facilities, installing equipment and training personnel under the driven, visionary leadership of its managing director. The organization faces new challenges as it gains recognition for its expanded role and redefined identity.

[Business-Government Relations, Business and Society, Economic Development, Finance, Information Systems, Marketing, Operations Management, Organizational Behavior, Strategy]

CONFEDERATION OF ZIMBABWE INDUSTRY (CZI) (Zimbabwe) is the group of large industrialists who meet in a men's club to discuss matters of common interest. They decide to focus on the need to forge ties between their large enterprises and the country's small indigenous black-owned businesses in order to create jobs, spread prosperity and build goodwill, so as to reduce racial tension in society. One new venture is subsequently proposed and examined. The characters who could play keys roles in this business outline their views and assess its prospects.

[Business-Government Relations, Business and Society, Economic Development, Entrepreneurship, Marketing, Negotiation, Operations Management, Organizational Behavior, Strategy]

ETM ENTERPRISES (Zimbabwe) is a small black-owned inner city transport business that is one of several ventures supplementing the income of a husband and wife team pursuing academic careers. A large bank is considering them as the first loan recipients of a new small business loan program recently established to finance indigenous enterprises.

[Entrepreneurship, Finance, Information Systems, Marketing, Negotiation, Operations Management, Organizational Behavior, Strategy]

FIE (Bolivia) is a micro-credit organization that has grown successfully for a decade by extending small loans to poor women across the country. Both the government and banking sectors regard this and related institutions as an increasingly attractive and vital force in the country, and the prospect of new regulation and new competition leads the management committee to debate three alternative institutional options for the future.

[Business-Government Relations, Business and Society, Economic Development, Entrepreneurship, Finance, Information Systems, International Economy, Organizational Behavior, Strategy]

FRANK DAVIS COMES TO MADAGASCAR (Madagascar) tells the story of an American food processing representative who visits the country seeking opportunities to export spices to the United States. His first few days in the country are filled with culture shock as he endeavors to understand how things work in this society. He arranges meetings with government officials and begins discussions with a local producer, and he is now expected to report an initial assessment of his firm's prospects for doing business to his U.S. headquarters.

[Business-Government Relations, Business and Society, Economic Development, Entrepreneurship, International Economy, Marketing, Operations Management, Organizational Behavior, Strategy]

GROWING PAINS (Nepal) portrays a dynamic financial institution that was the first private finance company in Nepal's newly deregulated financial market. A young MBA graduate has the challenging job of assessing why his institution's growth and profitability have been stunted compared to counterparts in this truly explosive financial sector. Performance to-date has been so disappointing that the managing director wants to release financial statements that mislead investors about current conditions at the company.

[Accounting, Business-Government Relations, Business and Society, Economic Development, Entrepreneurship, Finance, Marketing, Negotiation, Organizational Behavior, Strategy]

HOT BREADS (Nepal) is the Nepalese franchise of an Indian bakery that sells French-style pastries to upscale customers in the city center. Specially trained bakers sent there from India grow homesick and return home leaving the store understaffed and unable to meet demand. The store owners and managers debate whether to hire and train local people and risk breeding new competition.

[Business and Society, Entrepreneurship, International Economy, Marketing, Operations Management, Organizational Behavior, Strategy]

ZATON S.A.R.L. (Morocco) is a dynamic exporter of olives, peppers and capers that has grown dramatically through acquisition and overseas joint ventures. Family managers, traditionally unwilling to delegate now face serious control problems in their factories and office. Disappointing crop yields and operational problems are leaving customer assurances unfulfilled, and a key American customer is forced to buy the needed product elsewhere.

[Business and Society, Economic Development, Entrepreneurship, International Economy, Marketing, Operations Management, Organizational Behavior, Strategy]

SITHOLE UPHOLSTERERS (South Africa) is a manufacturer of fine upholstered furniture run by a father and mother with three grown sons. With the aid of a consultant, they learn their real costs of production and discover that some of their most popular products are actually sold under cost. Their furniture is of excellent quality, but Sithole's customers do not know the company's name. The pending question of management succession adds tension to the drama since family members are sharply at odds.

[Accounting, Entrepreneurship, Information Systems, Marketing, Operations Management, Organizational Behavior, Strategy]

TROIKA POTATO CHIPS (Russia) is the proposed venture of a farming cooperative, a food processor, and a food distribution group to produce and sell inexpensive potato chips by using locally grown produce in order to compete with the more costly imported varieties. The business plan outlines how Troika will work and describes clearly what each party brings to the venture. The plan is assessed by a British venture capitalist who has developed some rules of thumb for doing business in Russia. He regards the venture as one of the more promising proposals he's seen to-date.

[Entrepreneurship, Finance, International Economy, Operations Management, Organizational Behavior, Strategy]

TUTUFF EQUIPMENT IN GHANA (Ghana) tells of an American salesman representing a U.S. lumber equipment manufacturer looking for opportunities to export to Africa. The most promising prospect he identifies is a well-connected local Ghanaian logging operator who wants to forward integrate into furniture manufacturing instead of just exporting raw teak poles. He needs funds to purchase the equipment, and a British financier considers providing the finances to build a local relationship that holds future promise.

[Entrepreneurship, Finance, International Economy, Marketing, Negotiation, Operations Management, Organizational Behavior, Strategy]

Institutional Affiliation of Case Authors

CASE	COUNTRY	AUTHOR	INSTITUTIONAL AFFILIATION
Aprobe, Ltd.	Ghana	Nita Eckert	University of Illinois, Chicago
Box-It	Morocco	John Roundtree	University of Wisconsin, Madison
Caisse d'Epargne	Madagascar	Eileen McKeough	Yale University
CZI	Zimbabwe	Kenneth Meagor	Monterey Institute
ETM Enterprises	Zimbabwe	Michael Eber	Willamette University
FIE	Bolivia	Michael Aguilera	University of Washington
Frank Davis Comes to Madagascar	Madagascar	Valerie VinCola	Emory University
Growing Pains	Nepal	Catherine Rothenberger	Thunderbird
Hot Breads	Nepal	Julia Kreisinger	University of Massachusetts
ZATON	Morocco	Shawn Cochran	University of Connecticut
Sithole Upholsterers	South Africa	Hunter Moore	Texas A & M University
Troika Potato Chips	Russia	Gene Gutenberg	Cornell University
TuTuff Equipment in Ghana	Ghana	Christopher Shyers	Thunderbird

About the Authors

Name	*Institution*	*Assignment*	*Case*
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Shawn Cochran	University of Connecticut	Morocco	*ZATON*
Michael Eber	Willamette University	Zimbabwe	*ETM Enterprises*
Nita Eckert	University of Illinois, Chicago	Ghana	*Aprobe, Ltd.*
Gene Gutenberg	Cornell University	Russia	*Troika Potato Chips*
Julia Kreisinger	University of Massachusetts	Nepal	*Hot Breads*
Eileen McKeough	Yale University	Madagascar	*Caisse d'Epargne*
Kenneth Meagor	Monterey Institute	Zimbabwe	*CZI*
Hunter Moore	Texas A & M University	South Africa	*Sithole Upholsterers*
Catherine Rothenberger	Thunderbird	Nepal	*Growing Pains*
John Rountree	University of Wisconsin, Madison	Morocco	*Box-It, S.A.*
Christopher Shyers	Thunderbird	Ghana	*TuTuff Equipment in Ghana*
Valerie VinCola	Emory University	Madagascar	*Frank Davis Comes to Madagascar*

FIE

CENTRO DE FOMENTO A INICIATIVAS ECONÓMICAS (Center for the Development of Economic Initiatives)[1]

La Paz, Bolivia

The Executive Question

It was 8:30 a.m. when Jenny, the executive president's secretary, politely knocked on her boss' door to announce her arrival. She entered his office with his morning brew, an herbal tea, "mate de coca," that soothes the symptoms of altitude sickness commonly experienced in La Paz, which is more than 12,000 feet above sea level. She then reminded him that the regional directors of FIE—a Bolivian microcredit nonprofit lending institution—would be arriving within the hour for the annual director's meeting.

Enrique Soruco, executive president of this nonprofit institution, gazed across the stacks of papers on his desk, pondering the institution's latest challenges. FIE was facing pressing liquidity problems brought on by the organization's unprecedented growth in recent years and the unexpected decline in funding from international development organizations (IDOs). He was also concerned about the entry of other institutions into the microfinance business, transforming the industry from a colorful development fad into a highly competitive segment of the mainstream financial services industry.

He was further concerned that the government might formally begin to regulate the microfinance sector, constraining FIE's ability to compete by imposing strict new industry regulations. Government involvement might also create opportunities. It had recently created a new class of financial institution that was eligible to borrow funds from the country's Central Bank (CB) to lend to customers. Such firms could dramatically boost their lending capabilities. Enrique wondered if FIE should become one of these institutions, and if it did, could it realistically access those funds, or would the banking sector attempt to prohibit such borrowing?

Enrique picked up the circular he had mailed out a month before to his regional office directors (Exhibit 1). Given the notice's focus on performance results and the following year's incremental plans, he wondered whether the directors would be surprised by his intention to begin a frank assessment of FIE's legal status and competitive position at the day's annual meeting.

He also wondered how they could possibly discuss and formulate next year's goals when FIE's largest regions actually had difficulties meeting last year's goals. FIE's long-term prospects were now more uncertain and unstable than ever before. Enrique knew that the directors would be pushing for more financial resources to consolidate their offices, even in the midst of the organization's liquidity crisis. Further complicating the situation, the regional offices in La Paz and El Alto were nearing the magic 2,000 loan limit per office. Previous experience had demonstrated that offices could only manage up to 2,000 loans effectively; larger portfolios became unwieldy, and FIE wanted smaller, informal and user-friendly environments for its clients. Consequently, FIE needed to open two additional agencies in the cities of La Paz and El Alto this year, creating another demand for substantial cash investment.

As the forerunner of Bolivia's microcredit industry, FIE's credit methodology had become an important topic of discussion in development-minded intellectual circles around the world. That attention paved the way for

Exhibit 1

PRESIDENTIAL CIRCULAR
CENTRO DE FOMENTO A INICIATIVAS ECONÓMICAS (FIE)

FIE/EP/003/96

TO: Oscar Vedia, Regional Office LA PAZ
Elizabeth Chacón, Agency EL TEJAR
Maria V. Rojas de Schulze, Regional Office EL ALTO
Victor Huanaco, Agency 16 de JULIO
Roxana Nava, Regional Office SANTA CRUZ
Maria del Carmen Nava de Pereira, Agency PLAN 3000
Guillermo Guerra, Regional Office ORURO
Carlos Decker, Regional Office COCHABAMBA
Marcela Cox, Regional Office POTOSÍ
Maria Eugenia Mariscal, Regional Office TARIJA

FROM: Enrique Soruco
EXECUTIVE PRESIDENT

RE: **Annual Executive Staff and Director's Meeting**

This circular is to inform you that the annual Executive Staff and Director's meeting has been officially scheduled for Thursday and Friday, February 25-26. I have set the following items for the meeting's agenda:

(1) Review each Regional Office's and Agency's year-end operating results to the objectives that were set by the Credit Manager;

(2) Recommend changes to the Finance Manager and the Head Accountant for the accounting systems and operation procedures based on last year's operating results;

(3) Propose and approve next year's Credit Program goals and objectives for each Regional Office.

The meeting will begin at 9:00 a.m. and finish at 5:30 p.m. and there will be a three hour lunch break, from 12:00 p.m. to 3:00 p.m. Each Regional Office Director will be expected to present the office's year-end operating results to the Executive Staff and propose next year's goals. Please confirm your attendance with the Executive Secretary and direct any logistical questions to her as well. Each Director should contact the Credit Manager with any comments or questions regarding his/her office's and agency's year-end results or goals and objectives.

Sincerely,

La Paz, January 21, 1996

Enclosure: Credit Program Year-end Results and Review
cc: Credit Division Manager

ESV/jge

other international and local development institutions to launch programs in Bolivia, causing unanticipated, intense competition for limited IDO funds (both loans and donations) that were key to managing startup microcredit lending programs. FIE's credit program had benefited from these financial resources over the last ten years, allowing it to grow and prosper very well. But the program's resources were now being drained by other FIE divisions, notably the costly effort to provide entrepreneurial training to clients.

Further complicating the competitive situation was the unexpected drop in repayment of outstanding FIE loans. Historically, the default rate on FIE's loan portfolio had been less than one percent, an outstanding result that was rapidly drawing the attention of the formal banking sector. Many of Bolivia's banks were searching for ways to increase their loan portfolios and interest income, and FIE's experience had demonstrated that microfinance activities could provide high return at low risk. This created new competition for FIE's best clients, while remaining clients had irregular repayment records.

The distinction between the formal banking sector and the informal microfinance sector was blurring, raising concerns and questions regarding financial reporting and operational procedures. Most microcredit institu-

tions were nonprofit institutions that did not fall under the jurisdiction of the Superintendencia de Bancos y Entidades Financieras (Superintendency of Banks and Financial Entities), Bolivia's highest government regulatory body overseeing the banking industry (i.e., banks, credit unions and other financial institutions). This situation appeared ready for change, and FIE could soon face a new set of operating obligations and constraints.

Enrique reflected on the dramatic impact these changing external circumstances had on FIE's operations. The changed environment might require institutional transformation, but what that meant in the short- and long-term was unclear in his mind.

FIE's Background and History

In the early 1980s, four young professional Bolivian women—Maria Eugenia Butrón (administrator), Maria del Pilar Ramirez (psychologist), Maria V. Rojas de Schulze (social worker), and Maria Rosa del Pilar Velasco (social worker)—found themselves working together at the refugee center in La Paz, CESEM, the Centro de Estudios y Servicios Especializados en Migraciones Involuntarias (the Center of Studies and Specialized Services in Involuntary Migrations). CESEM was an agency of the United Nations High Commissioner for Refugees, or ACNUR,[2] which assisted Bolivian refugees returning home after living in exile in neighboring countries. ACNUR provided donations to help them start small businesses. Through this experience these women developed the idea of helping Bolivia's poor by providing access to credit rather than direct donations (as ACNUR did) in order to encourage them to consolidate their economic activities and direct their own future.

Thus, on November 13, 1985, these four women along with another, Helga Beatriz Salinas (also an administrator), established FIE as a private, nonprofit institution. It was founded to offer quality financial and nonfinancial services to the poor to promote the sustainable development of Bolivian microentrepreneurs and small businesses. Targeted businesses were owned by persons, families or groups living in poverty who had limited access to traditional sources of credit and training (Exhibit 2). FIE carried out its mission through an integral aid program that promoted both the microentrepreneur's productive and commercial activities. Services included credit for working capital and fixed investments; entrepreneurial development technical training; production training; technical assistance in organizational development; quality control technical assistance; marketing advisory services and financial advice for microentrepreneur organizations. The founders wanted to improve the relationship between lenders and the working poor who needed access to credit.

FIE sought a distinctive way to achieve its objective of supporting and empowering underdeveloped urban areas. Traditional aid only seemed to weaken people and perpetuate poverty. FIE wanted to extend credit to support the poor's income-generating activities in ways that resembled the services of banks. Experiences from around the world taught them that enviable repayment rates, notable increases in family income and significant improvements in living conditions were all possible using microcredit. This foundation guided the development of FIE's own credit methodology.

Prior to the official charter date, the founders spent several years working with different international and local development institutions, experimenting with credit operations and learning banking operation practices. FIE then developed a credit methodology tailored to the needs of its clients. FIE also began to develop accounting and management training techniques for its clients. It shared its ideas and methodology with other credit institutions dedicated to developmental change, hoping to foster teamwork and unity among players while providing more opportunities for the microentrepreneur. In 1988, FIE's credit program initiated its operations in La Paz, offering artisan and production credit lines. In that same year, it also introduced management training courses to all credit program clients. Training remained an important feature of FIE's offerings, though in recent years it had become a significant cash drain.

Over its first ten years, FIE approved more than 43,400 credits and disbursed over US$29.8 million. By early 1996, its capital totaled over US$2.2 million and its loan portfolio amounted to US$6.2 million, disbursed along four different credit lines: the production credit line, offering individual loans for producers and artisans; the commerce credit line, offering individual loans for merchants; the associations credit line, offering group loans for producers or small manufacturers; and the leasing credit line, offering lease financing. The last two offerings were fairly new. Thus far only four offices offered leasing loans and only one offered association loans, all within La Paz and El Alto, but there were plans to expand these products to other regions.

Exhibit 3 shows the kind of information collected by FIE evaluators for review and analysis before a commercial loan was extended. Evaluators first visited the applicant's business to examine machinery, equipment, materials, etc., and to learn how the applicant managed his or her business. The applicant was then invited to the office to conduct a feasibility study where terms of a loan were discussed. The evaluator considered the applicant's sales, costs, net income and personal expenses, and together they discussed the loan amount, loan term, interest rate, payment terms and collateral. Once

Exhibit 2

FIE'S STRATEGIC OBJECTIVE

FIE's strategic objective was to support the development of women, men, groups and organizations through economic empowerment, living condition improvements and the promotion of Bolivia's productive base. Its work was based upon the support of the following:

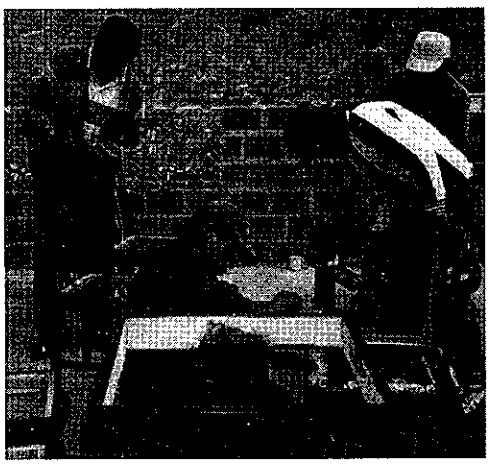
- to offer a microcredit support service to underdeveloped urban areas guided by a strong commitment to quality;
- to help the microentrepreneur reach her or his economic potential with the objective of contributing to favorable and sustainable social impacts;
- to offer a combination of actions including credit, training, technical assistance and commercialization, because together they better support the microentrepreneur's needs;
- to strengthen FIE's financial base so as to guarantee its capacity to finance future expansion into new services and other regions of Bolivia;
- to maintain a strong predisposition towards innovation and risk-taking in undertaking new challenges and
- to achieve the long-term sustainability of FIE's financial and nonfinancial services.

FIE'S CLIENTS

FIE's clients were the producers, merchants and artisans who lived in the economically poor areas of the cities and semi-urban zones of Bolivia that have limited access to the conventional financial system. They were women (60%) and men (40%) who developed their own economic activities to provide income to cover their basic living needs. The people adopted a production mode that did not clearly separate the owners from the labor force.

The owners hired few employees, if any at all, due to a lack of funds. Thus, many times they served as a worker and also enlisted their families as employees. The owners initiated production with great personal sacrifices, normally with very little capital endowment, in low-income market conditions, with little education and with deficient health services and work conditions. Most of the microentrepreneurs ran their businesses from home, which served a dual role as a productive unit and a source of income to cover the family's expenses.

Altogether, these activities represent 94% of the urban economic enterprises, employ 55% of the total urban labor force, incorporate 75% of the economically active women, and generate 65% of the national employment. They also produce a significant part of the country's Gross Domestic Product and provide the majority of the consumer products and services.



A carpenter and three employees financed by a FIE production credit

the information was gathered, a committee decided whether or not to approve the application. If the loan amount was over $2,500, the credit manager also participated in the committee decision.

FIE's active clients totaled more than 12,090 in number and the average loan size was US$688.60. Considering that FIE's clients had average monthly incomes of less than US$200, a loan of US$688 was a major investment. The average number of active clients per evaluator was 336, and their average loan portfolio was US$173,605. Over the years FIE expanded its financial service operations to seven regional offices and three agencies in the following cities: Cochabamba, El Alto, La Paz, Oruro, Potosí, Santa Cruz and Tarija. Additional information about the character and performance of these regional offices appears in Exhibits 4-10.

FIE's Organizational Structure

FIE's decisionmaking body was the General Assembly of Associates. Its legal representation and administrative functions were entrusted to a Board of Directors, designated by the General Assembly and presided over by the executive president, Enrique Soruco. He had been brought in as an outsider after most of FIE's founders had had their opportunity to serve as executive president. FIE separated its financial services area from its nonfinancial services area, with each having autonomous management and different sources of financing. (See organization charts in Exhibits 11 and 12 and employee headcount in Exhibit 13.) The operating units within each area were as follows: the financial services area contained the credit division and finance and operations division, and the nonfinancial

Exhibit 3

SAMPLE FEASIBILITY STUDY FORM-COMMERCE CREDIT LINE

Credit #: _____

Date: _____

Name: _____

Start Date of the Business: _____

Type of Authorization

Owned: _____ Rented: _____ Other: _____

RUC: _____

Patent: _____

Association: _____

Other: _____

Past Loans (amount, term and the institution's name): _____

Purchases and Sales:

Days of the Week	Purchases		Sales		
	Minimum Bs. (Bolivianos)	Maximum Bs. (Bolivianos)	Minimum Bs. (Bolivianos)	Maximum Bs. (Bolivianos)	Remarks
Monday					
Tuesday					
Wednesday					
Thursday					
Friday					
Saturday					
Sunday					
Total					

Average Weekly Purchases: _____

Average Weekly Sales: _____

What will you buy with the loan? _____

Principal Products:

Product	Purchases: Unit Cost	Sales: Unit Sales Price	Percentage of Earnings

What are your weekly earnings? Bs. _____

	Other Expenses	Amount	Payment Period
Assistant (Is he/she a relative?)			
Deposit			
Taxes			
Rent			
Caretaker			
Other (Please specify)			

Exhibit 3 (Continued)

SAMPLE FEASIBILITY STUDY FORM-COMMERCE CREDIT LINE

Weekly expenses: _____

Equipment that you have (cost) Bs. _____

_____

_____

_____

How much working capital? Bs. _____

How much do you withdraw from your business for your personal expenses? Bs. _____

Number of dependents: _____

Do you have other income sources? (Please specify): _____

_____

Other expenditures? (Debts, Family expenses, etc.): _____

_____

_____

Amount requested Bs.: _____ Amount recommended Bs.: _____

Term requested: _____ Term recommended: _____

Guarantee (Please specify): _____

_____

Product Origin

National: _____ %

Imported: _____ %

Cash: _____ %

Credit: _____ %

Consignment: _____ %

Payment Capacity (in Bolivianos): _____ %

Weekly Gross Margin: _____

(-) Weekly Expenses: _____

Balance: _____

Amortization:

(-) Principal: _____

(-) Interest: _____

Balance: _____

(+) Other Income: _____

(-) Family Allotment: _____

(-) Other Expenditures: _____

Net Balance _____

Suggestions (Positive Aspects, Negative Aspects, Recommendations):

_____

_____

_____

_____

Evaluator

Exhibit 4
MAP OF BOLIVIA

service area contained the entrepreneurial development and training divisions. The legal and auditor roles were provided on a contractual basis by external services.

The credit division was in charge of the loan portfolio, which included a variety of financial services for the microentrepreneur and small business. Loans were available to support production, commerce and leasing. The division had seven regional offices and three agencies. The finance and operation division was responsible for assuring the adequate cash flow for FIE's credit program and an efficient accounting system and management operation for the institution. The division was entrusted with the institution's administrative services.

Exhibit 5
INCOME STATEMENT–FIE CREDIT PROGRAM

Fiscal Year End	**12/31/93**	**12/31/94**	**12/31/95**	**3/31/96**
Income:				
Loan Interest Income	$670,359	$912,005	$1,129,426	$816,958
Other Interest Income	113,350	158,517	221,470	138,298
Total Interest Income	$783,709	$1,070,522	$1,350,896	$955,255
Financing Expenses:				
- Actual Interest Cost	$154,888	$268,730	$436,406	$311,831
- Market Price Adjustment	-	-	-	-
Total Financing Expenses	$154,888	$268,730	$436,406	$311,831
Net Interest Income	$628,821	$801,792	$914,490	$643,424
Rights and Other Operational Income	23,000	60,199	37,325	10,819
Net Income b/ Operating Expenses	$651,821	$861,991	$951,814	$654,243
Operating Expenses:				
Salaries:				
- Credit Team	$279,042	$349,790	$385,408	$215,606
Administration Costs	187,683	223,263	405,583	222,139
Depreciation	15,475	24,893	38,897	23,132
Provision for Bad Debts	30,790	39,384	56,039	28,115
Other Provisions	14,266	47,128	-	-
Other Operating Expenses	-	-	5,019	3,313
Total Operating Expenses	$527,257	$684,456	$890,946	$492,305
Income b/ Real Value Capital Mant.	$124,564	$177,535	$60,868	$161,938
Less: Real Value Capital Maintenance	157,774	140,197	26,264	(6,313)
Net Income b/ Operational Subsidy	$(33,211)	$37,338	$34,605	$168,251
Operational Subsidy	164,254	49,405	61,823	18,863
Net Period Earnings	**$131,043**	**$86,743**	**$96,428**	**$187,115**

Information Source: FIE's Accounting Management Report, March 1996

Exhibit 6

BALANCE SHEET–FIE CREDIT PROGRAM (in US dollars)

Fiscal Year End	12/31/93	12/31/94	12/31/95	3/31/96
Assets:				
Cash	$101,418	$70,218	$282,893	$97,973
Temporary Investments	-	100,000	568,578	461,944
Accounts Receivable	41,098	176,752	360,286	576,506
Other Current Assets	14,434	14,433	11,362	11,362
Loan Portfolio - 1 Year or Less	927,369	1,251,002	2,368,063	2,589,619
Total Current Assets	$1,084,318	$1,612,405	$3,591,181	$3,737,403
Long-Term Loan Portfolio	$2,139,843	$2,910,086	$3,552,094	$3,884,428
Less: Reserve for Bad Debts	74,232	99,088	111,277	129,530
Fixed Assets	195,365	368,500	428,112	470,537
Other Assets	33,298	25,894	59,782	58,390
Total Assets	$3,378,592	$4,817,797	$7,519,893	$8,021,227
Liabilities:				
Short-Term Loans	$948,004	$2,080,906	$3,036,623	$3,096,285
A/P and Other Short-Term Liabilities	91,218	124,594	181,575	188,282
Total Short-Term Liabilities	$1,039,222	$2,205,500	$3,218,198	$3,284,567
Long-Term Loans	$683,752	$761,045	$1,943,623	$2,141,457
Provisions	30,610	80,015	73,043	100,894
Total Liabilities	$1,753,585	$3,046,560	$5,234,863	$5,526,919
Capital:				
Capital from Donors:	$922,333	$879,160	$1,096,361	$1,155,683
- For the Loan Portfolio	922,333	879,160	1,096,361	1,155,683
Institutional Capital:	$702,673	$892,076	$1,188,669	$1,338,625
- Shareholder Capital	95,133	90,680	99,144	104,516
- Reserves	250,802	388,585	631,849	666,087
- Retained Earnings	225,694	326,069	361,248	380,908
- Net Period Earnings	131,043	86,743	96,428	187,115
Total Capital	$1,625,006	$1,771,237	$2,285,030	$2,494,308
Total Capital and Liabilities	$3,378,592	$4,817,797	$7,519,893	$8,021,227

Information Source: FIE's Accounting Management Report, March 1996

Exhibit 7

FIE'S LOAN PORTFOLIO EVOLUTION (in US dollars)

YEAR	NUMBER OF LOANS	AMOUNT DISBURSED	AVERAGE LOAN SIZE	CURRENT LOAN PORTFOLIO	NUMBER OF ACTIVE CLIENTS
1988	122	$95,101	$779.52	$81,020	122
1989	615	412,052	670.00	304,973	655
1990	1,060	765,970	722.61	605,551	1,097
1991	2,248	1,843,815	820.20	1,409,364	2,350
1992	3,934	2,725,094	692.70	2,081,696	3,614
1993	5,740	4,400,293	766.60	3,107,539	5,358
1994	8,362	6,644,977	794.66	4,159,224	6,310
1995	15,965	9,862,112	617.73	5,881,046	10,994
1st Quarter 1996	5,356	3,137,140	585.72	6,249,794	12,090
Totals	**43,402**	**$29,886,554**	**$688.60**	**N/A**	**N/A**

Information Source: FIE's Credit Management Report, March 1996

Exhibit 8

FIE'S LOAN PORTFOLIO COMPOSITION PER REGIONAL OFFICE-VALUE OF LOANS (in US dollars)

REGIONAL OFFICE	CREDIT LINES PRODUCTION	COMMERCE	ASSOCIATIONS	LEASING	TOTALS US DOLLARS	PERCENTAGE
La Paz	$2,042,625	$367,261	$272,821	$100,257	$2,782,964	44.53%
El Alto	1,264,931	220,360	-	81,941	1,567,232	25.08%
Santa Cruz	601,195	259,765	-	-	860,960	13.78%
Oruro	335,310	240,949	-	-	576,259	9.22%
Cochabamba	107,434	84,015	-	-	191,449	3.06%
Potosí	42,573	97,484	-	-	140,057	2.24%
Tarija	63,973	66,901	-	-	130,874	2.09%
Totals	**$4,458,041**	**$1,336,735**	**$272,821**	**$182,198**	**$6,249,795**	**N/A**
Percentage	71.33%	21.39%	4.37%	2.92%	N/A	100.00%

Information Source: FIE's Credit Management Report, March 1996

Exhibit 9

FIE'S LOAN PORTFOLIO PER REGIONAL OFFICE - NUMBER OF LOANS

REGIONAL OFFICE	CREDIT LINES PRODUCTION	COMMERCE	ASSOCIATIONS	LEASING	TOTALS US DOLLARS	PERCENTAGE
La Paz	2,185	1,360	362	58	3,965	32.80%
El Alto	1,949	782	-	40	2,771	22.92%
Santa Cruz	1,098	824	-	-	1,922	15.90%
Oruro	612	642	-	-	1,254	10.37%
Cochabamba	420	436	-	-	856	7.08%
Potosí	208	484	-	-	692	5.72%
Tarija	270	360	-	-	630	5.21%
Totals	**6,742**	**4,888**	**362**	**98**	**12,090**	**N/A**
Percentage	55.77%	40.43%	2.99%	0.81%	N/A	100.00%

Information Source: FIE's Credit Management Report, March 1996

Exhibit 10

FIE'S LOAN PORTFOLIO IN ARREARS PER REGIONAL OFFICE (in US dollars)

REGIONAL OFFICE	1-10 DAYS	11-30 DAYS	31-60 DAYS	61-90 DAYS	91+ DAYS	TOTALS
La Paz	$20,568	$11,978	$13,413	$7,013	$90,404	$143,376
El Alto	23,553	10,745	3,370	2,552	23,696	63,916
Santa Cruz	8,435	6,900	6,017	1,819	18,400	41,571
Oruro	4,452	4,369	2,050	1,838	12,501	25,210
Cochabamba	3,246	753	1,001	348	2,767	8,115
Potosí	2,448	1,910	1,387	619	1,311	7,675
Tarija	1,978	4,447	1,765	1,429	508	10,127
Totals	**$64,680**	**$41,102**	**$29,003**	**$15,618**	**$149,587**	**$299,990**
Percentage	1.03%	0.66%	0.46%	0.25%	2.39%	4.80%

Information Source: FIE's Credit Management Report, March 1996

The Bolivian Economy[3]

For the Bolivian economy, 1995 was a year that fell short of expectations but saw the implementation of some important economic and social structure reforms. GDP growth and inflation failed to meet government targets, but Bolivia experienced positive economic growth for the ninth year in a row. That year's 3.8% GDP growth was higher than the average for Latin American countries, and inflation was still at historically low levels. The successful privatization of four state-owned enterprises attracted large pledges of new investment and began the realignment of Bolivia's productive sector toward a market orientation.

The government's budget increasingly reflected a commitment to social spending (though its management was now largely in the hands of departmental and municipal authorities), and moved away from support of state-owned companies. Bolivia's banking sector survived a difficult year (discussed further below), and despite some serious remaining problems, was expected to improve in the next year. Bolivia was still heavily in debt (76% of GDP), but remained solvent. Despite record exports, Bolivia's trade deficit widened in 1995. Increasing private sector participation in the hydrocarbons and mining sectors compensated for a decline in government investment in state-owned companies. Bolivia's vast informal economy, including some illegal smuggling, continued to rival the formal sector in size and importance.

In 1996 the government hoped to complete its most important economic reform—privatization—by selling Bolivia's largest company, YPFB, the state-owned oil and gas company. Successful completion of this reform was not guaranteed, but it would complete privatization of Bolivia's major productive sectors, as well as attracting investment that would stimulate growth in telecommunications, hydrocarbons, electricity, transportation and mining well into the next century.

Bolivia's Banking Sector[4]

Despite appearing at times on the verge of a major catastrophe, Bolivia's banking sector survived a 1995 crisis year and showed promise for improvement. Bank deposits (dominated by U.S. dollar deposits) and liquidity increased slightly, but interest rates remained high (over 16% for U.S. dollar denominated loans) and the number of delinquent loans almost doubled that year. Figures summarizing macroeconomic and banking sector indicators appear in Exhibit 14.

The failure in June of the Cayman Islands' branch of Bank Bolivian American (BBA-International) sent a shock through the system. Eventual losses to depositors were nearly US$19 million. This collapse reinforced the

Exhibit 11
GENERAL ORGANIZATION STRUCTURE

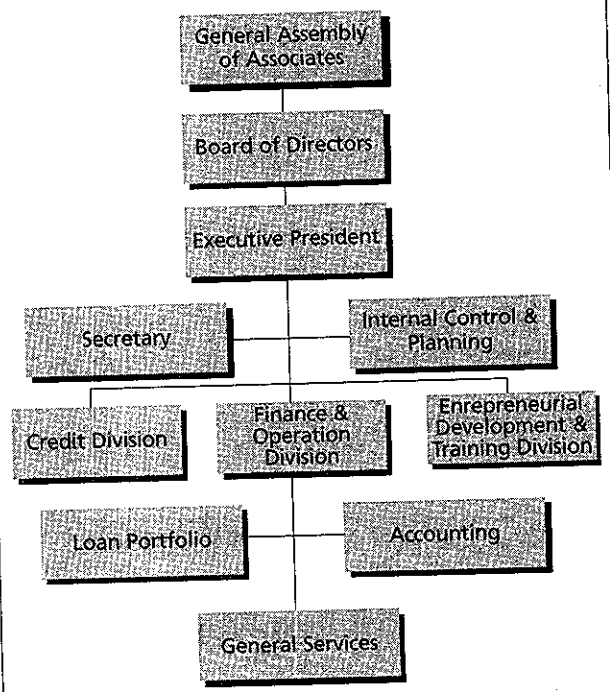
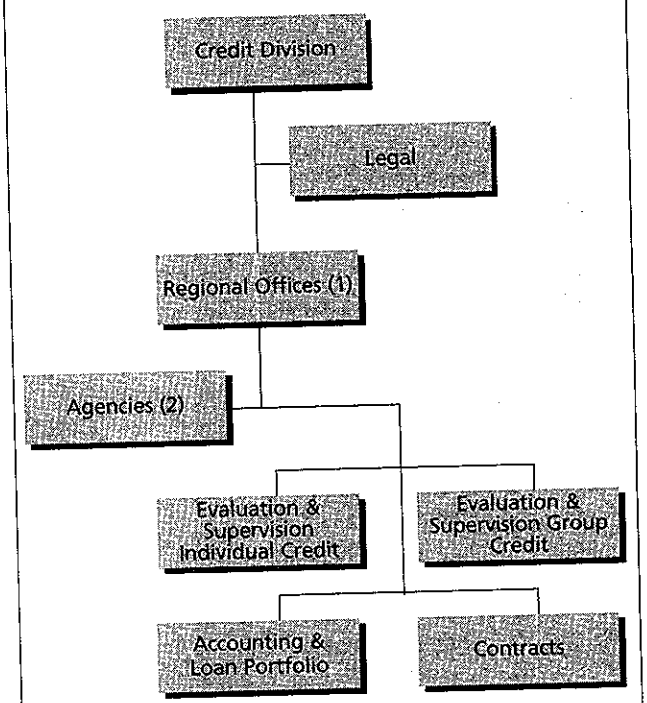


Exhibit 12
CREDIT DIVISION ORGANIZATIONAL STRUCTURE



(I) Offices are Cochabamba, El Alto, La Paz, Oruro, Potosí, Santa Cruz and Tarija.
(2) The agencies are El Tejar, 16 de Julio and Plan 3000. El Tejar reports to La Paz, 16 de Julio reports to El Alto and Plan 3000 reports to Santa Cruz.

Exhibit 13
NUMBER OF EMPLOYEES

YEAR END	1993	1994	1995	1996 (1)
National Office				
Executive Staff	2	2	3	3
Accounting	3	3	1	2
Portfolio Computer System Staff	1	2	2	2
Legal Staff	2	1	2	2
Executive Assistant	-	1	1	1
Investment Adviser	-	1	-	-
Administrator	1	-	-	-
Support Staff	4	4	4	4
Totals	**13**	**14**	**13**	**14**
Credit Division				
Regional and Agency Directors	3	6	9	10
Evaluators	21	19	36	36
Collectors	2	2	1	1
Accountants	-	1	3	3
Cashiers	1	6	7	9
Support Staff	7	10	12	12
Totals	**34**	**44**	**68**	**71**

Note: (1) As of March 1996

Information Source: FIE's Credit Management Report, March 19960

public perception of a deteriorating banking system that began when two banks failed two years earlier (Bank Sur and Bank Cochabamba). Confidence dropped, deposits declined and BBA and three other banks were rumored to be struggling for survival.

Since mid-year, however, several events helped stabilize the banking sector. Three banks—BBA, Bank Unión and Bides—were purchased at least in part by foreign investors who promised large injections of capital. Another bank, BHN Multibanco, was soon to be capitalized by Citibank. The government created a bank support fund of more than US$200 million to bolster capital-short banks. To qualify, banks had to submit acceptable proposals for better financial management. A new central bank law raised the capital/loan ratio requirement, banned new insider loans and required that existing insider loans be phased out over the next three years.

Confidence slowly returned, and by October banking deposits had stabilized. However, liquidity and deposits increased very little in the past year, insider lending continued to plague the system and loan defaults rose alarmingly. Interest rates remained high due to external factors and the Tequila effect (the devaluation of the Mexican peso that affected other Latin American countries). Private business complained that the lack of funds in banks for new loans was stifling its capacity to invest and grow.

Although the banking sector was far from being a sufficient lending machine for the growth of Bolivia's private sector, the removal of several of its most troubled banks from life support had at least eliminated the possibility of imminent widespread collapse. As new capital from the government fund and private investors entered the system, greater liquidity and more lending was expected. It would still take time to create a healthier credit climate based on sound financial decisions, so in 1996 people still expected more loan defaults from past insider lending.

Bolivia's Microfinance Sector

Through their work with disadvantaged individuals and groups, some nongovernmental organizations (NGOs) identified limited access to financing as a major obstacle to economic progress. As a result, several NGOs began to develop microcredit programs as a way to offer disadvantaged populations the financial and nonfinancial services they needed.

The microfinance sector included microfinance credit programs administered by formal and semiformal financial institutions. The formal institutions supervised by the Superintendencia included two entities: Banco Solidario **(nicknamed Banco Sol)**, a commercial bank that primarily assisted groups and Caja de Ahorro y Préstamos (the Savings and Loan Bank-Los Andes, S.A.), a Fondo Financiero Privado or FFP (Private Financial Fund) which assisted microentrepreneurs and small businesses with their working capital requirements. (FFPs are described further below.)

The semiformal financial institutions were the NGOs and other nonprofit institutions that offered credit programs in urban and semi-urban areas. They primarily served microentrepreneurs and small businesses and some served women exclusively. These included FIE and its primary competitors, including IDEPRO, or Instituto para el Desarrollo de la Pequeña Unidad Productiva (Small Productive Unit Development Institute); PRODEM, or Fundación para Promoción y Desarrollo de la MicroEmpresa (Foundation for the Microenterprise Development and Promotion); and FADES or Fundación para Alternativas de Desarrollo (Foundation for Development Alternatives). The size, growth and mix of loans from these institutions appear in Exhibits 15 and 16.

These institutions tailored their financial services to the needs of their clients and their own institutional requirements. Institutions serving microenterprises charged interest rates generally higher than the prevailing ones established in the financial markets. This stemmed from the need to assure financial viability in the medium- and long-term and to match the market's prevailing conditions.

It is worthwhile noting that interest rates charged by the microfinance credit programs were the inverse of the conventional banking system, insofar as banks generally tried to reduce their rates for competitive purposes while NGOs increased their charges to gradually eliminate the implicit subsidies in their credit programs. In 1996, some microfinance interest rates amply surpassed the banking sector's effective interest rates, particularly in programs based on experimental methodologies previously used outside Bolivia. As Exhibit 17 shows, there was great similarity among the different NGO programs with regard to lending terms and required guarantees.

Bolivia's Superintendencia de Bancos

Several years earlier the Superintendencia had begun to investigate the possibility of expanding Bolivia's banking system. The banking system, as noted above, had been experiencing liquidity problems, specifically in attracting enough people to make deposits into the system. Several prominent national newspapers had reported that the banking sector was a sitting time bomb because it was rumored that there were only 60,000 deposits in the entire banking system. If these

Exhibit 14

BOLIVIAN MACROENCONOMIC AND BANKING SECTOR INDICATORS

Indicators	1992	1993	1994	1995
Gross Domestic Product (2,4)	1.70%	4.00%	4.20%	3.80%
Inflation Rates (3)	10.46%	9.31%	8.52%	12.58%
Year End Exchange Rate (E)	Bs. 4.10	Bs. 4.48	Bs. 4.70	Bs. 4.94
Accumulated Annual Devaluation (2)	9.33%	9.27%	4.91%	5.11%
Total Banking System Deposits (3)	$ 1,544.80	$ 2,052.70	$ 2,167.40	$ 2,401.80 (1)
Change by Year	23.40%	32.90%	5.60%	10.80% (1)
Deposits in Foreign Denominations (2)	84.20%	81.80%	79.80%	82.30% (1)
Banking Liquidity (3)	$ 367.10	$ 552.20	$ 554.10	$ 606.30 (1)
Change By Year (2)	47.70%	50.40%	0.30%	9.40% (1)
Year End Loan Interest Rates:				
US dollars (2)	17.43%	16.36%	15.15%	18.35%
Bolivianos (2)	43.73%	43.53%	40.18%	30.09%
Year End Term Deposit Interest Rates:				
US dollars (2)	11.17%	9.83%	9.25%	10.55%
Bolivianos (2)	21.78%	18.40%	14.81%	16.36%
Delinquent Loans (3)	$ 121.60	$ 149.00	$ 91.80	$ 173.80
Change by Year (2)	7.80%	22.50%	-38.40%	89.30%
Delinquent Loans/Portfolio (2)	6.60%	6.30%	3.70%	6.20%

Notes: (E) Sale of Bolivianos, (1) Estimation, (2) In percentage, (3) In millions of US dollars, (4) Annual variation

Exhibit 15

LOAN PORTFOLIO EVOLUTION PER INSTITUTION (in US dollars

INSTITUTION	LOAN PORTFOLIO 1994	1995	ACCUMULATED USERS	CURRENT USERS
BANCO SOL	$33,214,457	$36,857,090	432,982	63,038
FIE	4,159,225	6,118,654	38,046	10,994
LOS ANDES	2,863,000	5,953,000	63,303	13,849
IDEPRO	1,494,612	2,160,416	13,946	7,494
CIDRE	653,753	638,883	933	329
PROA	873,108	1,114,732	1,255	417
FUNBODEM	214,265	420,435	1,249	421
PRODEM	2,615,812	4,516,521	18,309	-
FADES	3,068,395	4,555,080	26,620	-
SARTAWI	1,214,361	1,274,973	5,566	-
ANAPRI	N/A	1,589,297	3,933	99,644
TOTALS	**$43,472,420**	**$65,199,081**	**555,647**	**196,186**

Information Source: CIPAME, 1995

Exhibit 16

LOAN PORTFOLIO PER INSTITUTION (in US dollars)

INSTITUTION	ACCUMULATED DISBURSEMENTS	LOAN PORTFOLIO GROSS	CURRENT	PAYABLE	EXECUTED	ARREARS
BANCO SOL	$230,520,030	$36,857,090	$35,725,077	$612,230	$519,783	$1,132,013
FIE	26,749,414	5,881,046	5,643438	237,608	-	237,508
LOS ANDES	31,718,000	5,953,000	5,649,792	297,500	5,708	303,208
IDEPRO	12,872,803	2,160,416	2,012,640	128,101	19,675	147,776
CIDRE	2,437,856	638,883	625,900	9,247	3,736	12,983
PROA	3,292,505	1,114,732	1,101,992	11,902	838	12,740
FUNBODEM	627,080	420,435	408,265	5,949	6,221	12,170
PRODEM	N/A	4,516,521	4,512,952	1,380	2,513	-
FADES	N/A	4,555,080	4,157,808	146,186	251,086	-
SARTAWI	N/A	1,274,973	1,216,792	32,264	25,917	-
ANAPRI	2,580,672	1,589,297	1,255,843	207,067	126,387	333,454
TOTALS	**$310,798,360**	**$64,961473**	**$62,310,499**	**$1,689,434**	**$961,864**	**$2,191,852**

Information Source: CIPAME and FINRURAL, 1995

Exhibit 17

PRODUCTS AND FINANCING TERMS PER INSTITUTION

Micro-Finance Programs	Nominal Interest Rate(1)	Average Loan Amount	Average Period (months)	Amortization (2)	Guarantees (3)
BANCO					
Local Currency	48.0% LC	$ 270	5.0	W,F	6
- With value Maintenance	30.0% FC	365	12.0	W,F,M	6
FIE					
– Commerce	36.0% LC	$ 424	2.5	W,F,M	1
– Production	24.0% FC	930	12.4	M	1,3,4,5
– Leasing	22.0% FC	1,900	24.0	M	2,7
LOS ANDES					
– Production	36% LC	$ 515	7.0	F,M	1,2,4
- Commerce	42.0% LC	515	7.0	W,F,M	1,2
IDEPRO					
– Small Business	21.0% FC	$ 190	3.0	W,F,M	6
– Development Credit	21.0% FC	2,000	16.0	M	1,4,7
– Associate Credit	21.0% FC	365	5.0	W,F,M	5,6
CIDRE	16.0% FC	$ 2,476	21.0	M	1.4
PROA	21.0% FC	$ 1,200	12.0	M	1
FUNBODEM	16.0% FC	$ 1,300	-	M	1,2
ANAPRI	N/A	N/A	N/A	N/A	N/A

1) Annual nominal interest rates: LC=Loans in local currency, FC=Loans in foreign currency or with a clause of value maintenance.

2) Amortization period: W=Weekly, F=Fortnightly, M=Monthly.

3) Indicated in order of priority, is the type of guarantee most frequently utilized by each program: 1=Personal, 2=Collateral, 3=Telephone Line, 4=Mortgage, 5=Guarantee Fund, 6=Solidary group, 7=Personal pledge.

Information Source: CASANOVAS, R;op.cit.

depositors withdrew their monies, many feared the entire system would collapse.

The Superintendencia had been observing with interest the growth of the new microfinance sector, trying to determine how the organizations in this sector could possibly alleviate the liquidity problems of the banking sector. One proposal was to have microfinance institutions encourage their customers to deposit money in the private banking system. The banking sector usually did not serve this population, since the poor were unable to provide normal guarantees, such as collateral for financial services. In return, the Superintendencia thought that it might be able to provide microfinance organizations with potential access to the Central Bank's funds to alleviate their liquidity problems.

Thus, with the assistance of the U.S. Agency for International Development (USAID), which was looking to assist the microfinance sector, the Superintendencia approved a new strategy that created a new class of financial institution within the banking sector, namely El Fondo Financiero Privado (FFP). The FFP was to be a financial entity in between a nonprofit organization and a bank, potentially bridging the large gap between the two. Banks normally shunned microentrepreneurs, while nonprofit microfinance institutions were unable to offer services beyond small loans.

The FFP would be able to offer savings instruments as part of its financial services package, which nonprofits were prohibited from offering. The FFP could offer savings in two basic forms: short-term savings deposits and longer-term certificate of deposits. More importantly, the FFP would have access to the Central Bank's funds and be able to borrow up to 12.5 times its net worth. Furthermore, the FFP would not be regulated by the same set of rigid standards that applied to the country's banks. Rather, there would be a new set of standards that would strengthen the financial and operational standing of member organizations. The main limitation for a FFP would be that it could not offer checking

account services or perform international transactions as banks do.

For nonprofit organizations, this move by the Superintendencia was seen as a huge step towards alleviating the liquidity problems plaguing the microfinance sector. Under this charter, the stronger microcredit programs would be able to meet the ever-increasing demands of their clients.

The Executive Question Revisited

During its first ten years, FIE had experienced extraordinary growth. This growth enabled the credit program to reach a significant industry milestone of financial self-sustainment (the ability to self-finance) much earlier than anticipated. There were basically two levels of self-sustainment. The first was operational self-sustainment, meaning that FIE generated sufficient operating income to cover its operating expenses, but not its financial expenses. The second and higher level was financial self-sustainment, meaning that FIE generated sufficient operating income to cover both its operational and financial expenses. Recent growth suggested that demand for microfinance services would not decline anytime soon, so institutions targeted financial self-sustainment as a desirable and achievable way to operate in Bolivia.

But as in any growing institution, FIE was still feeling the strain and effects of limited resources. This appeared dramatically in its inability to meet current client demands in a timely fashion. (During November-December, a loan disbursement could take up to 60 days.) It also limited its plans to expand into new semi-urban areas and to open the two new agencies in La Paz and El Alto, given that existing offices were operating at capacity. As more IDOs considered FIE an institution with considerable experience and expertise in its specialty area, IDO donations and low-interest loans shrunk. The IDOs generally provided FIE with financial and technical assistance only for the programs requiring consolidation and new programs under development (especially women's programs). As a result, IDOs expected FIE to make notable steps towards financial self-sustainment over the term of their support. Their goal was to provide funding to permit FIE to improve its operations and strengthen its loan portfolio so that it could broaden its funding opportunities by borrowing from other financial entities, such as banks.

To further complicate matters, current and potential creditors were demanding that FIE implement stricter reporting guidelines and more reliable internal controls. Over the years, FIE had dedicated a significant amount of its financial and human resources to the development and growth of its credit program. However, this had come at the expense of developing its accounting and financial operations systems. This resulted in two almost completely incompatible systems that could hardly communicate with one another. Thus, FIE seemed to have an unwanted reputation for being notoriously late in submitting financial statements and progress reports to its creditors, perhaps discouraging their additional funding. It could not meet specified deadlines due to its poorly managed operations system. It took on average 90 days for the head accountant to close the various accounting ledgers and prepare a draft of the financial results for review by the executive staff. Final approval would then take a few more weeks to allow time for routine adjustments.

Complicating the situation was FIE's approach towards work. It routinely faced crises instead of planning its future. For example, FIE tended to fulfill creditor requests for information or reports at the last possible moment. At present there were no controls in place to remind the staff of creditor deadlines. Usually a staff employee or the credit manager would recall that a creditor request must be completed in the next few days. FIE's creditors were beginning to demand that FIE implement immediate corrective actions. This surely had bearing on FIE's ability to secure financial resources for the future.

FIE was also experiencing an unexpected side effect from its employee recruitment program. As the institution had grown in size, it had hired new employees without ever specifying recruiting guidelines. FIE regularly hired university students in the midst of their college programs to attract inexpensive talent with no specific education or background experience. FIE believed it could train its employees to learn the FIE way, regardless of their education or experience. What they had not realized was that this effort to minimize salary expenses meant that FIE now lacked employees with banking experience or financial education common to banks and required by the Superintendencia.

Yet over these same years, this lack of a banking atmosphere at FIE helped create a rather informal and friendly work climate. A strong family orientation was present in FIE's company culture and this helped foster an enormous amount of friendship and respect among the majority of coworkers. Routinely a group of between 5 and 30 employees went out drinking and singing together at the end of the week. These friendships were the basis for the strong sense of trust that dominated the organization.

FIE's Annual Executive Staff and Director's Meeting

The time had arrived for the regional office and agency directors to convene at FIE's national office in La Paz with the executive staff for the annual director's meeting.

Exhibit 18

CREDIT PROGRAM 1995 YEAR-END RESULTS AND REVIEW (in US Dollars)

DETAIL	GOALS PROPOSED NUMBER OF LOAN	GOALS PROPOSED AMOUNT TO DISBURSE	RESULTS ACHIEVED NUMBER OF LOANS	RESULTS ACHIEVED AMOUNT DISBURSED	PERCENTAGE VARIATION NUMBER OF LOANS	PERCENTAGE VARIATION AMOUNT DISBURSED
Regional Office La Paz						
- Production	1,600	$2,080,000	1,082	$1,279,709	-32.4%	-38.5%
- Commerce	2,500	1,125,000	2,599	1,265,405	4.0%	12.5%
- Associations	375	506,250	238	290,200	-36.5%	-42.7%
- Leasing	90	225,000	21	54,856	-76.7%	-75.6%
Agency El Tejar						
- Production	600	780,000	715	812,438	19.2%	4.2%
- Commerce	700	280,000	744	296,750	6.3%	6.0%
- Leasing	24	36,000	25	47,429	4.2%	31.7%
Total Region La Paz	5,889	$5,032,250	5,424	$4,046,787	-7.9%	-19.6%
Regional Office El Alto						
- Production	1,500	$1,350,000	1,172	$1,064,170	-21.9%	-21.2%
- Commerce	800	200,000	852	316,080	6.5%	58.0%
- Leasing	36	90,000	13	29,420	-63.9%	-67.3%
Agency 16 de Julio						
- Production	600	450,000	681	559,066	13.5%	24.2%
- Commerce	800	200,000	575	233,541	-28.1%	16.8%
- Leasing	12	18,000	5	14,950	-58.3%	-16.9%
Total Region El Alto	3,748	$2,308,000	3,298	$2,217,227	-12.0%	-3.9%
Regional Office Oruro						
- Production	300	$240,000	599	$431,188	99.7%	79.7%
- Commerce	1,200	480,000	1,334	651,832	11.2%	35.8%
Total Region Oruro	1,500	$720,000	1,933	$1,083,020	28.9%	50.4%
Regional Office Santa Cruz						
- Production	750	$750,000	619	$667,622	-17.5%	-11.0%
- Commerce	500	400,000	669	554,227	33.8%	38.6%
Agency Plan 3000 (1)						
- Production	-	-	494	186,815	N/A	N/A
- Commerce	-	-	571	182,467	N/A	N/A
Total Region Santa Cruz	1,250	$1,150,000	2,353	$1,591,131	88.2%	38.4%
Regional Office Cochabamba						
- Production	400	$320,000	517	$238,724	29.3%	-25.4%
- Commerce	600	240,000	967	280,012	61.2%	16.7%
Total Region Cochabamba	1,000	$560,000	1,484	$518,736	48.4%	-7.4%
Regional Office Potosí (1)						
- Production	-	$-	196	$57,780	N/A	N/A
- Commerce	-	-	764	197,711	N/A	N/A
Total Region Potosí	-	$-	960	$255,491	N/A	N/A
Regional Office Tarija (1)						
- Production	-	$-	181	$54,577	N/A	N/A
- Commerce	-	-	332	95,142	N/A	N/A
Total Region Tarija	-	$-	513	$149,719	N/A	N/A
Total Credit Program	**13,387**	**$9,770,250**	**15,965**	**$9,862,111**	**19.3%**	**0.9%**

Note (1): Agency Plan 3000, Regional Office Potosí, and Regional Office Tarija initiated operations in the 2nd and 3rd quarters of 1995.

The annual meeting generally provided the management staff with an opportunity to review the credit program's previous year's performance by (1) analyzing the program's accomplishments and shortcomings, (2) recommending appropriate changes and modifications to the program and (3) approving next year's goals and objectives for the Credit Division. However, it also provided the executive staff with an opportunity to announce or discuss pressing organizational issues. Enrique already knew that there was more on the agenda for this year's annual meeting than just approving next year's program goals and objectives. The meeting would begin the process of determining FIE's long-term strategy for growth and stability.

It was now 10:00 a.m., although the meeting had been scheduled for 9:00.[5] Enrique's secretary came to advise him that all the directors had finally arrived and they were now ready to begin the meeting. Rising to join them, Enrique paused for a brief moment to appreciate the special decorations that now hung in his office as part of current holiday festivities. It was Carnival season, and this meant it was time to *challar* everything he owned to request good luck for the coming year. *Challar*—a word in the Amayra language, a dialect widely spoken in Bolivia—meant to ask Mother Earth to watch over and protect worldly possessions and bring good luck in the coming year. As he *challared* the items in his office, Enrique thought the coming year would have special meaning for him and all of FIE associates and clients. The organization definitely needed good luck if it was to transform itself to better serve its clients, the microentrepreneurs and small businesses of Bolivia.

After talking informally for some time, discussing family, friends, local news, even the results of recent World Cup qualifying soccer games, the meeting finally came to order. "Good morning to everyone. I am happy to see you have all arrived safely," Enrique began. "I would like to begin this year's annual meeting with a review of the credit program's year-end results (Exhibit 18)." As the directors pulled out their handout, Jenny knocked on the door, walked into the meeting room, handed Enrique an envelope and whispered, "This memo just arrived from USAID. The messenger indicated that it was urgent and that I should deliver it to you as soon as possible." After thanking her, Enrique opened the envelope to find inside an urgent memo from USAID (Exhibit 19) calling upon FIE to "clean up its act" administratively or face an imminent, severe funding cutback.

Enrique again addressed the directors. "It appears that I have a bit of distressing news. As most of you should know, USAID recently finished conducting an audit of our accounting and operational systems. I now have the audit results that USAID just sent me and they are not very promising. USAID expects FIE to make certain improvements in its systems or else risk having our funding frozen by USAID." Though uncomfortable with this news, Enrique immediately realized that this blunt feedback created an ideal opportunity to begin discussing the organizational issues he had been pondering regarding FIE's future.

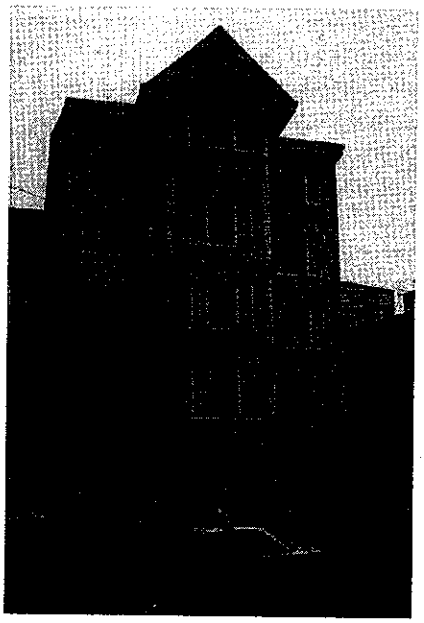
"FIE has enjoyed a lot of success during its first ten years of operation," said Enrique. "Beginning as a local player, FIE is now a national provider of credit to Bolivia's major urban areas. However, FIE is now at an important juncture in its history where a change may be needed to meet the new challenges and problems we face, such as indicated by this USAID memo. The problems they mention here we have known about for some time, but now we must finally address them."

Enrique paused for a moment, then continued. "Although FIE has achieved its year-end goals, two offices actually experienced a decrease and were unable to achieve their goals. If FIE is to continue to move forward, I strongly believe that now is the time for us to discuss our thoughts about how FIE should position itself as a major player in the future of the microfinance industry." In Enrique's mind, there was nowhere to go except towards additional growth.

A temporary silence came over the meeting as the directors absorbed what Enrique had just announced. The first person to speak was Oscar Vedia, director of the regional office La Paz. Oscar had been with FIE for more than six years, first working as a loan evaluator. When the La Paz regional office was opened, the credit manager personally selected Oscar to assume the director's position. Oscar was considered one of the better directors within FIE, but he had no formal training in business, as he had studied electrical engineering. Oscar addressed Enrique respectfully, as all employees addressed their superiors: "Licenciado,[6] with regard to your call for suggestions, I would like to voice my opinions regarding the future path FIE should be undertaking. As we all are aware, FIE has been developing some pretty severe liquidity problems, which have critically affected the regional office under my supervision. Due to the growth, many of the funds that were originally to be utilized here were diverted to other offices like Potosí and Tarija to get them up and running," a fact that had quite frustrated him earlier in the year. "As a result, my office has been put at a disadvantage and we were unable to meet our goals set by the credit manager."

Oscar continued, "I have been here for over six years now and seen the incredible growth of FIE and the entire credit industry. I see a lot of potential for our future, but we need to seriously address our liquidity problems. We have already seen one member of the industry become what FIE should become. It is Banco Sol, one of our competitors. Banco Sol transformed itself from a nonprofit institution into a regulated

Staff members of the Potosí Regional Office



FIE's main office building in the city of La Paz

bank. (It was previously affiliated with PRODEM. PRODEM tended to rural areas, while Banco Sol concentrated on more urban areas.) We can now see the success they have seen: they now have over $36 million in their loan portfolio and currently over 63,000 users of their financial services. Certainly they have experienced problems as any growing organization would, but the advantages most certainly outweigh the costs and risks. They now have access to the Central Bank's funds, which we most certainly could use. Now that Banco Sol is regulated by the Superintendencia, it has given them greater credibility with its current and future creditors. That is the future path for FIE, especially if FIE wants to be a leader in the industry and set the standards versus playing follow the leader."

Roxana Nava, director of the regional office Santa Cruz, then added her opinions. She had been with FIE for more than five years and was also a member of FIE's general assembly. She had significant business education and training, and she helped FIE develop its accounting and loan portfolio systems. She was also one of three sisters working at FIE. Roxana supervised one of her sisters, Maria del Carmen Nava de Pereira (the director of the agency "Plan 3000"), and the third, the credit division manager, supervised both of them. "*Licenciado* Enrique and my fellow directors, I would also like to offer my thoughts regarding FIE's future path in the credit industry. We have all seen the dramatic increase in the number of organizations offering services in the credit industry and, fortunately, FIE has been among the leaders. FIE must change so that FIE can continue to meet its clients' demands and eliminate the long waits for disbursements from new credit applications that sometimes results from our lack of funds. But I am not sure I agree with my colleague that transforming into a bank is the correct path for FIE."

She continued, "Yes, there are certain benefits that come with such a transformation, as Oscar has pointed out, but would FIE actually be ready and able to function as a bank? I am not so sure. Most of the employees do not have direct experience or training to work as a bank. FIE may be stepping out of bounds by taking on such a huge transformation. Furthermore, would we be able to uphold FIE's original vision, or would the Superintendencia's rigid control prevent FIE from serving those whom FIE first intended to serve, the disadvantaged urban sectors of Bolivia? I believe that we should pursue the new FFP financial entity that the Superintendencia approved recently. This would give FIE many of the advantages of a bank, but we would still be exempt from certain banking regulations. What's more important, one of our principal competitors, Los Andes, has already been approved as a FFP, and it is ready to surpass FIE in its loan portfolio size. This is definitely a cause for concern." Los Andes had been founded by a former member of FIE who had left to start his own nonprofit institution, and it now competed for financial support from the same IDOs. To many in the room, it was a matter of personal pride how FIE faired relative to Los Andes.

One of the directors in attendance, Maria Rojas de Schulze of the regional office El Alto, was also one of FIE's original founders and a member of its board of directors. She did not have any direct experience in banking or business other than her ten years with FIE, where she basically learned the business from the ground up. But she had a strong desire to make the vision of FIE a reality in all the urban and rural sectors

of Bolivia. She also had a special position in FIE and could push her ideas through the chain of command due her status as one of its founders.

As soon as Roxana finished, Maria jumped in, "My fellow colleagues, I do admire your desire to continue the growth and success of FIE, but I must say that I am a bit concerned about the measures you are suggesting. You must remember that I helped found this institution on the premise that FIE would serve those people who were shut off from the formal banking sector. It has been this desire that has enabled us to grow so successfully over the last decade. I fear that if FIE were to pursue the other options mentioned, FIE would forget about those whom I want to help. FIE would become just like the other formal financial institutions and measure everything based on the bottom line. I strongly recommend that FIE remain as it is, so as not to alienate its clientele. We have come this far as a nonprofit institution and achieved much success, so I do not see any reason why we cannot continue as we are, enjoying the success we have had and further realizing the dream that I first had ten years ago."

The director said, "I thank you very much for your comments. It appears that FIE has some distinct viable options to position itself for the future. I would like to recommend that we nominate a team to research the various options and return with a recommendation one month hence."

FIE's Future Path

FIE now faced a tough strategic decision regarding its institutional future. Possibly a major change was needed to ready FIE for its second decade as a continued leader in the microcredit lending industry. If FIE wished to continue growing in servicing the demands of its clients, it would have to search out new funding sources to help resolve its liquidity problems. What is more, it would have to assess the attractiveness of emerging opportunities (such as FFP status) and ready itself to face coming threats (such as the banks' possible entry into the microfinance industry). If the banks did enter the microcredit business, would the Superintendencia begin to regulate the industry by imposing stricter guidelines? As a nonprofit institution, FIE had heretofore enjoyed exemption from current banking and government regulations.

A few options seemed clear for the future of FIE. It could continue to operate as a nonprofit institution as it had for the last decade, and compete with other nonprofit organizations for low-interest financial resources from the IDOs. However, these financial resources were becoming less available to FIE as more and more institutions competed for them. This was in part attributable to FIE's paving the way for other nonprofit organizations to start credit programs in La Paz and other Bolivian cities, and perhaps was also attributable to FIE's lax discipline in dealing with the IDOs. Even if FIE remained a nonprofit, it still had to strengthen internal financial controls and eliminate liquidity problems. The cleanup of administrative systems and procedures for internal control and coordination was a long awaited improvement, yet it eventually took the external pressure from aid agencies to force management to attend to these matters.

FIE could transform itself into a bank and acquire the advantages of operating as a formal financial institution, such as offering new financial services like saving and checking accounts, loans and other international services. However, to become a bank, FIE would have to undergo a notable reorganization and dramatically improve its financial operations to comply with stricter

Traditional challar ceremony requesting blessings for the coming year

Dancing "the Morenada" during Bolivia's carnival in the city of Oruro

Exhibit 19

USAID/BOLIVIA MEMORANDUM

UNITED STATES GOVERNMENT

memorandum

CONT-96/0224
February 24, 1996

Reply to: Denise Fernandez, Financial Analyst, USAID

Subject: Institutional Revision of the Center for the Development of Economic Initiatives (FIE)

Reference: The Microenterprise and Small Business Development Project 511-059x

To: Enrique Soruco, Executive President, FIE

Through: Richard J. Goughnour, Country Director, USAID

After a complete revision of FIE's accounting and credit systems, I am recommending that USAID/Bolivia conditionally continue to grant new financial resources for FIE's Credit Program. This condition will be removed once FIE has demonstrated that it has improved its financial internal controls and operations procedures to properly manage the assigned funds. The following list details the deficiencies I observed in FIE's operations and systems:

Organizational Structure - Adjust the organizational chart to accurately reflect the existing positions within FIE.

Manuals - Create a Manual of Employee Functions to reflect the characteristics of the adjusted organizational chart. Revise the administrative and financial practices of the Credit Division to achieve an adequate control of its operations. Create a Manual of Personnel Administration that clearly indicates the prevailing procedures of the institution.

Personnel - The National Office should exercise greater control over the hiring of personnel for the Regional Offices and Agencies. Complete the personnel files so that they may be effectively used for employee evaluations and promotions.

Accounting System and Internal Control - Evaluate the functions realized by the Regional Offices to ensure adequate norms and internal control. Consolidate the accounting and loan portfolio systems so that they are available and accessible to the entire organization.

Budgets and Control - Implement budgets for all of FIE's Divisions to facilitate implementation and evaluation. Design and implement an adequate budget control that responds to FIE's needs and improves the control of financial resources.

Periodic Reports - FIE should adequately file its monthly and quarterly reports for future institutional revisions.

Inventory Control - Make a complete list of all the equipment and furniture under FIE's custody, clearly identified with its code.

I consider these deficiencies to be the priorities that FIE needs to resolve before any further funds are disbursed to the institution. By April 1, I will return to FIE to evaluate the progress on the improvements. If FIE has not satisfactorily completed the above revisions, I will recommend that USAID/Bolivia freeze any further disbursements of funds to FIE.

banking regulations and guidelines. Certain in-house issues must be examined and resolved, including: (a) building operational systems to strengthen internal financial controls, (b) reducing or eliminating liquidity problems to satisfy client demands promptly, (c) finding needed training programs to teach its personnel banking procedures and (d) combining its organizational culture with the Superintendencia's rigid control without losing sight of FIE's vision and objective. In addition, FIE must begin (e) offering high quality products and services in an increasingly competitive market where the competition continuously grows and develops new services that better satisfy client expectations and (f) profitably combining a new financial savings product with its Credit Program. There were legitimate questions regarding whether or not an organization can successfully undergo or "stomach" so much change.

Finally, FIE could venture down the new path offered by the Superintendencia—to become an FFP. This option seemed promising, as it would allow FIE to offer saving products which could attract new funds for its Credit Program. Most importantly, FIE would gain access to the Central Bank's funds for future lending to clients. However, there was not enough information available to see how viable this option would be, whether or not the Superintendencia would actively promote it and whether the banks could block its rollout. Several nonprofit institutions were already taking necessary steps

A evaluator from El Alto considering a loan application from a woman seeking a commerce credit line

to apply for the FFP license. Perhaps it would be better for FIE to wait to see if they were successful, then FIE could proceed later.

But Enrique knew FIE could not afford to wait and watch. Time was no longer a luxury; the future had arrived and it was time to take action now to move FIE into what Enrique hoped would be its second successful decade as a leader in the microcredit lending industry. He had to consider carefully the people and culture of FIE to judge the whether they had the ability, willingness and commitment to undergo serious organizational change.

NOTES

1. This case was written by Michael Aguilera of the University of Washington. It is intended as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. Special thanks to Professor Pamela Posey of the University of Washington and Professor Richard Linowes of American University for their help and guidance in the development of this case.

2. Alto Comisionado de Naciones Unidas para Refugiados (ACNUR).

3. Source of Information: Bolivian Economy Report, American Embassy Bolivia, 1996.

4. Ibid.

5. Culturally, it is rare to begin a meeting on time.

6. *Licenciado* was originally a term used to show respect to a person who had completed a formal program of education at a university level. Informally, it has become customary to use the title as a general sign of respect to any other person of higher rank, such as a supervisor or manager.

Troika Potato Chips (A)[1]

St. Petersburg, Russia

John Mirren drummed his fingers impatiently on the dashboard as he sat in the usual Moscow traffic jam. He was a managing director of a British-owned, Moscow-based investment fund that made investments in various businesses throughout Russia. John saw many business plans, written with various degrees of competence, every week, and he had to decide which ones warranted further investigation. As part of his job, he visited companies that seemed especially promising.

John left his job at a London investment boutique in 1990 to take a job in Russia at a time when Russia was considered the land of unlimited opportunity. He had a background in the region because he studied Russian history, literature, and language in university and had spent a year in St. Petersburg writing his senior thesis. As managing director of the investment fund, he had been extensively involved in evaluating and managing many projects, a few of which turned out to be spectacular successes, but many of them barely broke even and some were complete failures.

That week he was considering several plans. There was a furniture factory in Novosibirsk that was making good quality copies of Russian Empire furniture, as well as more modern furniture, and it needed investment money to expand operations. An interesting proposal — to open a fast food restaurant in Yekatrinburg — had come into the office last week. That seemed very promising since the potential manager had considerable restaurant experience, both domestic and international. There was also a proposal to open sorely needed self-service laundries in Moscow. However, that proposal needed careful examination since they were asking for a considerable sum of money.

A more modest business plan had come from St. Petersburg. Three different legal entities with experience and expertise in different fields had joined together to propose a company to produce and sell potato chips to the St. Petersburg market.

The formal business plan for this proposed startup follows. John had to decide if the business warranted his investment, given all he had learned about investing in Russia (see Appendix).

Business Plan[2]

Summary

The proposed project envisions the establishment of a new enterprise that will produce high-quality, competitively-priced potato chips in the town of Komarovo, not far from St. Petersburg.[3] The initiators have formed a separate legal entity called "Troika" specifically for the purpose of realizing the project. The potato chips will be sold under the "Troika" brand name.

The initiators hope to attract an outside equity investor and use the invested funds to purchase specialized, high-quality, imported processing equipment that will enable them to produce and package world-class potato chips to be sold through both wholesalers and retailers in the Leningrad Oblast (region).

The preparatory stage has been completed, and practically all key aspects have been worked out by the ini-

tiators. The enterprise has acquired a production site (building and land) and a specialized potato storage facility. With the purchase and installation of processing equipment, and a complete renovation of the production site, production can begin. A preliminary agreement to purchase equipment has been reached with a Dutch firm considered a leading producer of food processing equipment.

The principal raw ingredient, potatoes, will be supplied by the agricultural consortium Komarovo which is one of the founding partners in Troika.

The financial requirements for the realization of the above project are as follows: an equity investment of $803,600 for the purchase of production equipment, and a short-term credit of $236,000 for startup capital.

The time frame for the realization of the project is 10.5 years. The expected net profit at the end of this period is $2,269,000. Profits will be reinvested to modernize or expand existing operations or used to start a new venture.

The Enterprise

GENERAL INFORMATION

Troika is registered as a closed joint-stock company in the town of Komarovo, Leningrad Oblast.[4] The venture's principal activity is the processing of agricultural products, specifically, the production of potato chips.

Troika's founding partners are three independently registered organizations. The first is the agricultural Consortium "Komarovo," a closed joint-stock company which was a state-owned farm until 1994. Komarovo owns 11,500 hectares of farm land, and it is the largest producer of potatoes in Russia's northwestern region. The second is "Baikal," a joint-stock company formed in 1995 by a group of producers, wholesalers, and retailers of food products.[5] Together, Baikal's shareholders make up a developed distribution network covering St. Petersburg and the surrounding region. The last is "Znamya," also a closed joint-stock company whose principal activity is processing agricultural products.

CONTRIBUTED CAPITAL

As of July 1, 1995, stockholders' equity totals 100,000,000 rubles [US$1 = 5,000 rubles at that time]. There are 100 shares of common stock, each with a nominal value of 1,000,000 rubles. Komarovo and Baikal each own 40% of the shares, and the remaining 20% is held by Znamya.

The founders of Troika contributed the following assets, in lieu of cash, for shares in the enterprise:

> Komarovo - building and land to be used for production, valued at 40,000,000 rubles;
>
> Baikal - access to a distribution network covering the CIS, contribution valued at 40,000,000 rubles;
>
> Znamya - potato storage facility valued at 20,000,000 rubles.

The initiators agreed that Baikal would withhold its cash contribution of 40 million rubles until the purchase and installation of production equipment. Thus, as of July 1, 1995, 60 out of 100 shares of common stock were paid for in full.

APPRAISING MARKET VALUE OF STOCKHOLDERS' EQUITY

Since Troika is a newly created enterprise, it has not incurred any debt or losses. The fixed assets owned by the company are as follows:

land	1.5 hectare
building	420 sq. meters
potato storage facility	480 sq. meters

In order to minimize taxes, the Founding Charter assigns to assets the lowest possible value allowed by Russian law. The actual market value of these assets is significantly higher.[6] For example, the cost of property in the area is between $10,000 and $15,000 per hectare. The cost of constructing a similar building is $84,000, and the storage facility has been appraised at $60,000. Thus, the actual market value of Troika's fixed assets is approximately $159,000 but that would fluctuate as the political and economic climate in Russia changes.

DECISION MAKING

Regular shareholder meetings are to be held twice a year. Additional meetings can be initiated by a shareholder holding a minimum of 25% of common (voting) shares. Decisions can be approved provided shareholders holding a minimum of 50% of voting shares are present. Critical decisions, such as changing the Charter, re-organization, and liquidation of assets, require a 75% presence.

Troika will be managed by a Board of Directors, appointed by shareholders, with Alexander I. Ivanov serving as chairman.

PROFIT SHARING

Net profits will be distributed among shareholders as dividends. The dividends are to be approved at general shareholder meetings.

The Product

Troika potato chips will be produced and packaged with equipment manufactured by a Dutch firm, Florigio Industrie, using only natural, high-quality ingredients. The principal raw ingredient is potatoes, not the customary processed potato concentrate, so as to give the finished product a more natural potato taste and smell.

Florigio Industrie is a leading producer of food-processing technology. This technology will enable Troika to produce both regular chips and flavored chips up to the highest world standards. The chips will be packaged in 100 gram plastic packets bearing the company logo. Highest quality packaging materials (also Dutch) will be used, ensuring the chips remain fresh for up to six months. Package labeling will be in Russian.

Since potato chips are neither a staple nor a luxury product, demand is determined by price and quality. Troika chips will be cheaper than imported brands and of higher quality than domestic brands, so it is expected that they will be very popular.

Analysis of Market and Competition

Potato chips were produced locally in the 1960s and 1970s, then discontinued until 1992. Local market research indicates that the product currently enjoys a 90% awareness among the population.

In St. Petersburg, Western-style supermarkets selling brand name, imported products carry the widest assortment of potato chips. These supermarkets cater to consumers with high purchasing power. Potato chips are also available in food stores selling primarily Russian products and in 10 to 15% of all kiosks.[7] These stores offer a narrower range of products and usually carry no more than two brands of potato chips.

Market research shows that about 60% of the local population consumes potato chips with some regularity. A large segment of potato chip consumers is aged between 5 and 18. At the moment, the market has no obvious leader.

Since market research indicates that potato chips are a price elastic product in high demand, it could be concluded that expanding the consumer base by lowering the price would greatly increase sales. A consumer survey conducted by the St. Petersburg State University Economics Department confirms this fact, showing that 90% of potential buyers of potato chips refrain from buying due to high price. The remaining 10% choose not to buy because of perceived low quality or for some other reason. The survey also found that lowering the price of potato chips by 30% makes them affordable to 20-30% of potential consumers, compared to the 10% potential buyers who can afford to buy them at today's prices.

Troika's main competitors are foreign producers, followed by domestic producers. Domestic competition is not likely to become a factor for at least 3 to 4 years. Presently, the region is supplied by Finnish, Dutch, Israeli, and American producers. Retail prices for imported potato chips sold in elite supermarkets are between $.95 and $1.65 per 100 g package, making them affordable to only 7-10% of the population. Other stores sell chips at comparatively lower prices, from $.75 to $.90 per 100 g. These chips are produced by Russian, Baltic, and Polish companies.

Some widely distributed brands of potato chips and their prices per 100 g package are as follows:

SUPER	(Holland)	$1.12 to $1.52
SPECIAL SNACKS	(Moscow)	$ .56
MINI SNACK	(Israel)	$1.43
RAFFLES	(Poland)	$1.74

Koloss, another major domestic brand, is also relatively inexpensive. Due to a number of factors, primarily high tariffs, retail prices of imported chips are kept relatively high. Thus, only a limited number local wholesalers can afford to purchase potato chips from abroad. In fact, a survey of the wholesale market showed that imported potato chips are distributed by only three of the 15 largest wholesalers of food products in the area. Of the 20 largest supermarkets in St. Petersburg, only four sell potato chips. These figures demonstrate that choice and availability of potato chips in St. Petersburg and the surrounding area is limited.

At the moment, no local producers of potato chips use imported, high-quality equipment. In general, the simple, low-tech processes employed by these companies make them incapable of producing on a mass scale. Furthermore, the packaging of local chips is not consistent with world standards.

A careful pricing strategy, a high quality product, and good packaging will enable Troika to successfully compete with local as well as foreign producers. Troika chips will differ from imports in price (30-40% cheaper), and from domestic substitutes in quality and packaging. Until more local mass-producers of potato chips enter the market, which is not likely to occur for the next three to four years, the demand for the product will remain unsatisfied. By the time equilibrium is reached, Troika is expected to have gained a 5% share of the local market, producing and selling 289 tons of chips per year.

In summary, the market situation can be characterized as follows:

absence of a clear market leader

limited choice and availability of high quality potato chips

high price elasticity for the product

slowly but steadily increasing demand

increased domestic competition in the next three to four years

Marketing and Pricing Strategy

The marketing plan consists of three general components: (1) pricing strategy, (2) advertising campaign, and (3) continuous analysis of the changing market situation and integration of new information into overall strategy.

The product's competitive advantage is based on its:

- high quality
- image (modern, eye-catching package design)
- low production cost (use of locally grown potatoes)
- being ahead of domestic competition

Since market research shows there is unmet local demand, Troika chips will be marketed initially in the St. Petersburg region using Baikal's distribution network of over 400 selling points. When the local market is saturated, other regions will be explored.

In the first five years, growth in sales will be based on the expansion of the consumer base rather than on the elimination of competition. Troika chips will be priced on average 35% cheaper than imports, and 10-20% cheaper than domestic substitutes, making them affordable to a larger segment of population.

The minimum wholesale price of $0.4125 allows retail prices to be maintained at competitive levels. The use of local potatoes minimizes expenditures on the principal raw ingredient, since potatoes supplied by other regions have a 10-15% mark-up reflecting added transportation costs. Raw material expenses (potatoes, oil, spices, etc.) constitute 80% of total production costs (Exhibit 6). Competitive pricing will allow Troika to realize its sales objectives.

Product image will play a significant role in attracting potential buyers. The chips will be packaged in multicolor polypropylene packages that prominently display the Troika brand name. The packaging will be modeled after Western standards both in quality and presentation and in guarantees of freshness. In order not to alienate Russian buyers, information and company logo displayed on the package will be in Russian.[8] The product weighs 100 g and will be distributed to retailers in cardboard boxes.

The product will be promoted through a multi-stage advertising campaign utilizing printed and electronic media. The first stage of the campaign will focus on gaining maximum exposure and creating brand awareness for Troika potato chips. The product will be introduced with printed advertisements placed in buses, metros, trains, and points of purchase. Promotions will be held at trade fairs, at local civic celebrations, and in schools. A qualified marketing manager will be hired to develop strategy and manage all marketing efforts.

It is estimated that within the first two years of the project, the cost of advertising will reach approximately $15,000 annually. As local competitors enter the market, advertising expenditures will be increased and the advertising strategy will be modified accordingly. At this stage, advertising will become more aggressive, focusing on maintaining market position as well as on attracting buyers of other brands. Advertisements on local radio and television will be added at this time. By the third year, advertising expenditures are expected to increase to about $25,000 annually.

Troika has obtained all necessary licenses, including certification from the Ministry of Agriculture, to produce and sell its products.

Organization of the Production Process

The initiators have worked out all key operational aspects. All actions will be performed according to the schedule shown in Exhibit 1. The preparatory stage, during which equipment will be installed, building renovated, and personnel trained, will last six months. Full production capacity is expected to be reached four months after the start of production.

The production line requires a space measuring 200 square meters with a height of 3 meters. With the completion of renovation, which includes replacing electrical and water provision systems, the production site will satisfy all technical requirements. Beyond housing the production line, the building will contain an office, kitchen, bathrooms, and space for storing packaging materials. The site is easily accessible from a major highway.

An agrarian specialist will be hired to ensure that the potatoes purchased are of the highest quality. To prevent rotting, the potatoes will be stored in a specially adapted warehouse. A permanent contract with the potato supplier Komarovo is in effect. The Consortium owns 300 hectares of farmland, each producing between 16 and 18 tons of potatoes per year. Vegetable oil will be supplied by ARKO, a company located in a city about 400 miles south of St. Petersburg. The initiators of Troika have close ties with this supplier as well.

The production equipment supplied by the Dutch firm Florigio comes with enough spare parts for one year of operation. The choice of Florigio as equipment supplier is based on (1) its competitive price among imported analogues, and (2) its higher quality compared to similar domestic equipment. The production line is capable of processing 400 kg of potatoes per hour, resulting in 100 kg of finished potato chips every hour. Approximately 5% of completed product is expected to

be defective. Florigio would also supply packaging materials that come imprinted with the company logo and product information in Russian.

Production will go into recess during July and August when harvested potatoes are unsuitable for potato chips. The enterprise plans to hire a 22-person staff. The technical personnel will undergo a training session conducted by Florigio experts who will remain two months at the Troika production site. Training expense totals $7,500 and is included in the budget. All equipment maintenance work will be performed by specialists trained by Florigio.

Risk Factors

The following list identifies some of the risks facing the enterprise.

1. High rate of inflation, coupled with frequent changes in tax and licensing requirements, encumbers long-term financial planning and cost estimation.
2. The initiators have no experience in potato chip production.
3. A bad potato harvest could have a negative impact on quality, quantity, and price of potato supplies.
4. The break-up of the former Soviet Union has ruptured old inter-regional ties that formerly guaranteed a regular supply of raw materials.
5. The start of production could be postponed due to delays in delivery and installation of equipment or a delay in the completion of building renovation.
6. The initiators could encounter difficulties in obtaining financing.
7. Competition from domestic producers may have greater impact than expected.

All of the above factors are taken into consideration in making financial projections.

The organizers are engaged in a search for an additional source of potatoes in case there are problems with the contracted suppliers. Competition from local producers will not be a factor for at least three to four years and therefore will have no negative impact on the economics of the project in the first stages. When competitors do enter the market, Troika will have established a strong market presence with its products enjoying wide brand awareness.

Financing and Distribution of Profits

The initiators considered two possible methods for financing the purchase of equipment: leasing and equity investment. Since leasing laws in Russia have not yet stabilized, they are seeking an outside investor. This investor will be offered newly issued stock in the enterprise. The total amount required of the investor is $837,100. The initiators will contribute $132,700.

Funds will be invested in the enterprise in the following order:

1. Baikal will contribute 40,000,000 as payment for its shares in the enterprise (40 shares at nominal price of 1,000,000 rubles).[9]
2. Redistribution of common shares: Komarovo and Baikal will purchase 10 and 5 shares each, in that order, from Znamya.
3. The second stock offering will be organized, and an equity investor brought in.

After the outside investor is brought in, common (voting) shares would be distributed as follows:

investor:	up to 40%
Baikal:	25-30%
Komarovo:	30%
Znamya:	up to 5%

Limiting the investors' share to a maximum of 40% of common stock is a condition set at the insistence of the Leningrad Oblast Administration, which is a 49% owner of Baikal.

All profits will be distributed as dividends in proportion to ownership stake. Priority will be given to shareholders whose contribution financed the purchase of equipment and the renovation of production site.

Troika proposes to issue 65 additional shares of common stock and 43 shares of preferred stock of Type A and Type B. The holder of preferred shares has no voice in the management of the enterprise, but has priority in dividend distribution.

DISTRIBUTION OF SHARES AMONG THE STOCKHOLDERS AFTER SECOND STOCK OFFERING

	DISTRIBUTION OF COMMON SHARES BEFORE INVESTMENT		DISTRIBUTION OF COMMON SHARES AFTER INVESTMENT		DISTRIBUTION OF PREFERRED SHARES	
	Number of shares	%	Number of shares	%	Type A	Type B
Komarovo	40	40	50	30.3	—	—
Baikal	40	40	45	27.27	—	14
Znamya	20	20	5	3.03	—	—
Investor	—	—	65	39.39	29	—
TOTAL	100	100	165	100.00	43	

The face value of each share would remain 1,000,000 rubles. After the second stock offering, Troika's stockholders' equity will have a nominal value of

208,000,000 rubles.[10] Preferred stock would constitute 20.7% of total capital, well within the bounds of the law which places a 25% cap on preferred shares. Shares would be sold at a price of $8,905 per share. The investor would acquire 94 shares (65 common, 29 preferred) for a sum of $837,100; Baikal would purchase 14 newly issued preferred shares for $124,700.

Setting the actual price above the nominal price would have no tax implications. According to Russian securities law, when shares are sold to raise starting capital, the difference between nominal and actual price paid for each share is considered additional paid-in capital, not as taxable revenue.

Net profit will be distributed in the following order: (1) fixed dividends are paid to holders of preferred stock Type A, (2) dividends are paid to holders of Type B shares, (3) the remainder will be distributed among holders of common stock. Common and Type B stock holders will not receive any dividends until the holders of Type A stock are fully reimbursed the amount of investment ($837,100). After the fourth year, the 29 shares of preferred stock type A guarantee the investor a dividend income of $160,000 (Exhibit 9). Holders of Type B shares would receive yearly dividends of $9,000, starting in the fifth year of operation.

Since there is no undistributed income (retained earnings) at the end of the ten year realization period, the value of owner's equity would equal the nominal price of shares plus additional paid-in-capital. Initial stockholders' equity was formed with each partner's contribution (land, building, etc.). The maximum market value of stockholder's equity before the second stock offering is appraised at $159,000. Taking depreciation into account, this value is reduced to $123,000 at the end of 10 years. The total market value of Troika's assets is therefore $1,084,800: $123,000, the depreciated value of stockholders' equity before second offering, plus $961,800, the increase in stockholders' equity after second stock offering.

At the end of the 10-year operation period, the investors will have the option of selling back all preferred shares. Type A shares will be re-purchased for $692,000, and Type B shares, held by Baikal, for $32,000. The subsequent market value of Troika's common shares will be $369,000.[11] Holders of preferred stock would also have the option to convert their holdings into common stock.

Financial Planning

All major expenditures will be made in accordance with the work schedule (Exhibit 1). Funds will be used primarily to:

- purchase equipment
- renovate the production site
- purchase transportation vehicles
- create a reserve fund

The three sources of financing are as follows: equity investment, initiators' contribution, and short-term credits. Short-term credit is needed to satisfy initial working capital requirements. The first credit, totaling $188,000, will be for a three months and will be used to pay the VAT on the imported equipment. The second credit, totaling $48,000, will be for four months and will be used to purchase potatoes, oil, and other inputs. Principle and interest expense (30% annually) on these loans will be paid out of sales revenue.

The initiators will purchase automobiles for delivery of the product and pay the full cost of renovating the building out of their contributed funds. Equity investment will be used primarily for purchasing production equipment.

Financial projections are provided in attached Exhibits 2 - 9. Exhibit 6 shows production expenses with a 5% defect rate. Purchases of raw materials, particularly potatoes, make up the largest portion of expenses. Results of an analysis of potato price movements show that prices are stable, indicating that the market is in equilibrium. Potato prices in St. Petersburg reflect the average world price of the commodity.[12]

Prices of raw materials and maintenance costs are projected to rise 2% per year, beginning in the third year of production. Salaries are projected to rise 5% per year in the first four years, and 3% per year for the remainder of the ten year period. By basing projections on rising cost for inputs and stable selling price for the product, the initiators compensate for the possibility of an unexpected adverse turn of events.

Break-even analysis shows that the enterprise must produce 121 tons of potato chips per year to break even, only 42% of its capacity. Cash flow projections (Exhibit 8) show that sales revenue will be sufficient to cover all production and dividend expenses and future preferred stock repurchase.

Troika's projected income statement (Exhibit 9) also shows positive results, even in the first year of production. Income is projected to grow from $126,000 in the first year to a $263,000 in the fourth year, and gradually decrease to $216,000 in the tenth year. Income grows as a result of increased production efficiency and then declines because projected expenses rise while selling price is maintained constant. The enterprise is expected to generate an average return of 23% on investment. A portion of these earnings can be reinvested to modernize and expand current operations, or as starting capital for a new enterprise.

Appendix

CULTURAL AND SOCIOLOGICAL NOTES

The Russian Sense of Time

A Russian's sense of time may differ markedly from an American's. While Americans watch situation comedies where everything ends happily in a half-hour, the traditional Russian prefers three hour-long operas and theater pieces where a bad situation gets worse, people get emotional, and apparently nothing is resolved at the end. While Americans like to come quickly to the point and summarize their interests in a few sentences, Russian general managers usually choose to explain their corporate history and general philosophy before talking about specifics. This is often due to the Russian need to establish a relationship with a potential business partner. However, this differing sense of time can lead to confusion and a sense of distrust during initial meetings.

Openness versus Secrecy

Russia is a country that has been invaded many times during its history. Because of this legacy, Russians tend to keep their wealth and their business dealings secret. Just as a Russian peasant hid his grain, a Russian business tends to conceal its income, assets, and technological secrets. Russians are often reluctant to share information over the phone or in letters, and prefer at least a face-to-face meeting before going forward with details.

Obedience versus Autonomy

Another painful legacy of Russian history is servitude. Up to the middle of the 19th century, the majority of Russians were peasants, who essentially were the property of local landowners. The peasants followed the landowner's orders and were not permitted to move or change jobs without his permission. Under the Soviet system, the entire economy was centrally planned. At the time of this case, Russian decision making, particularly in large organizations, still came from the top. The Russian employee traditionally had little or no autonomy, and, during this transition to capitalism, many Russians were still reluctant to make decisions without consulting superiors. This cultural difference baffles and frustrates many Americans. The Russian decision-making process will seem very slow to an American, with inexplicable starts, stops, and reversals. American managers often must wait for months for a final decision to come from the top on matters already reviewed by layers of Russian managers. During the first few months working for a Western firm, new Russian employees often exasperate their American managers with their continual requests for precise instructions and direction.

Attitude toward Law and Contracts

For many years, Soviet law viewed capitalism and business as a social evil. For many Russians, the idea that laws could actually help build companies is relatively new concept. While Americans prefer to base their business relationships on legally enforceable contracts, many Russians still doubt the value of and lack respect for business laws and contracts. Many Russians prefer to keep their business dealings and accounts as far from government scrutiny as possible.

The Importance of Relationships

Most Russians business dealings are based on personal relationships. When making business decisions, Americans tend to focus on comparing contracts and prices. Russians, on the other hand, compare the depths of personal relationships. Most Russians prefer to do business with people who are close friends. Without a close personal relationship, often one that seems so close as to be claustrophobic to a Westerner, a Russian business deal is on shaky ground. For Americans, the contract is usually the centerpiece of negotiating sessions. For the Russian, the relationship is the focal point, and contracts and protocols are often merely thought of as polite ceremonies and starting points for further negotiation. Because Russians consider their business partners to be friends, Russian business leaders often have trouble saying no, and will promise things they cannot — or do not want — to deliver.

Most deals are done on the basis of a verbal agreement, where both sides actually appear to be embarrassed to bring any formalities into the process. This is one of the major factors contributing to an enormous crisis in the early 1990s stemming from the failure of almost everyone to pay their debts. The combined debt that enterprises owed to each other amounted to trillions of rubles, and a significant part of that was not supported by proper documentation.

Organized Crime

Dealing with organized crime is fundamental to doing business in Russia. Typically, banks have informers who tell the Mafia organs about incoming funds (sums above 10 million rubles.) Equipped with this information, the Mafia attempts to extort money from the enterprise. Insistent young men approach the management, in teams of three or four people. Having made an appointment, they announce that they have come to discuss the topic of "protection" or are representatives of tax authorities or the police. They offer their "services" in the form of protecting the life of the firm's owners and safeguarding of goods and property of the firm. If the owner refuses, they start explaining, very politely, that they can provide very effective personal security, and then, depending on the reaction, they start giving out information about the company

obtained from the bank, about the goods stored in the warehouse, his wife's place of work, the time his children are in school and all sorts of compromising information. If there is still no reaction, direct threats are brought into play.

Ultimately, most enterprises conclude security agreements with organized crime groups. According to standard contracts, the director has to make a monthly payment on a strictly defined day to a particular person. The sum is set depending on the turnover and the amount of compromising information about the firm. In the event that representatives of other groups approach the firm, the directors must prove that they already have protection or krysha (roof), so that representatives of the Mafia groups sort out between themselves questions concerning turf and what belongs to whom.

If a company does not have a krysha, it becomes difficult to conduct business, especially receiving payments, and the company is totally exposed. But if one does have krysha, one is breaking the law, placing oneself outside of it in the realm of the informal and vague. The relationship with one's krysha is very important, but at the same time it makes one a part of a network, thereby severely restricting one's freedom.

Working with Russian Partners

Although each investment opportunity presented its own unique set of characteristics and challenges, John found that there were many common elements and pitfalls when dealing with Russian partners as a foreign investor. For example:

- Most Russian entrepreneurs do not have a current, updated packet of information about their enterprise and/or project. At the initial meeting, they will most likely present old information and explain the project-at-hand orally, or as the Russians say, "using their fingers." Because written data seldom matches what is transmitted orally at the initial meeting, a foreign investor, upon reviewing the information packet, could become confused and distrustful.

- Russian citizens have grown accustomed to being secretive, a survival trait developed while living under a totalitarian regime. Consequently, the Russian entrepreneur is psychologically unprepared to reveal immediately all required information about his enterprise or project. He provides partial information, assuming that is sufficient for analysis. If obtaining information about a project or company begins to feel like pulling teeth, the investor may become suspicious and reluctant to proceed further.

- Russian entrepreneurs are not used to the language and protocol for attracting equity financing. They may ask potential investors to specify their requirements and then come up with a project to fit those requirements.

- Russian businessmen view unfavorably the Russian assistants employed by foreign consulting firms and investment funds. Most of these jobs are filled by young bilingual Russian "consultants" with some rudimentary knowledge of Western finance, but with virtually no experience in managing a business in Russia and a limited understanding of Russia's business climate. In worst cases, they become a buffer between the investor and the entrepreneur, filtering and sometimes misrepresenting information about the investment project. Generally, Russian businessmen prefer to stay in direct contact with the investor.

- The majority of Russian entrepreneurs are not accustomed to valuing other people's time, or paying for information or consulting services.

Working and investing in Russia is a continual learning process. The road to success is often paved with mistakes. During his stay, John made plenty of mistakes. He was able to identify the following lessons or "guidelines for practice" learned through his experience:

- At the initial meeting, set the tone and language for future discussions (whoever has the money gets to make the rules).

- Make a clear and firm request for all necessary information. If the requested information is not presented at the following meeting, end the meeting, clearly explaining the reasons for doing so.

- If you receive the necessary documents and, after evaluating them, refuse to finance the project, return the packet of information with an official letter explaining your decision.

- Before making any decision, consult a Russian expert. The most qualified experts are lawyers who are on top of current legal changes and know the system, or entrepreneurs who have had first-hand experience running a business in Russia. Some caution should be exercised in taking advice from foreign or Russian consultants who have no experience managing a business in Russia.

- The quality of management takes precedence over financial projections as the most

important factor in evaluating potential projects in Russia. Because the instability of the Russian market makes long-term planning virtually impossible, most Russian entrepreneurs regard the business plan as a formality in attracting foreign capital rather than an actual blueprint for running their business. Therefore, the investor should concentrate on those sections of the business plan which give some indication of management's style and degree of professionalism. These sections may deal with marketing research, risk assessment, sensitivity analysis, and project realization.

- In order to live through the years of economic transition, which is far from complete, Russian business people developed certain survival traits and habits. A dearth of information, unfair taxation, and rampant corruption have made them very cautious, while an unstable legal and economic infrastructure has made them extremely competent in analyzing and quickly responding to new risks and obstacles. Consequently, a Russian entrepreneur can quickly assess and exploit any weakness or incompetence he perceives in a potential business partner.

NOTES

1. This case was written by Gene Gutenberg of Cornell University. It is intended as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

2. Actual business plan presented to investors. All names have been changed.

3. Second largest city in Russia with a population of 5.5 million.

4. Enterprise whose shares are not publicly traded. Similar to a limited partnership.

5. Enterprise whose shares are publicly traded.

6. It is beyond the scope of this case study to discuss the intricacies of the Russian accounting and tax systems. It is highly recommended that a qualified Russian lawyer be consulted in all commercial transactions.

7. A small street shop that primarily sells snacks, cigarettes, and alcoholic and non-alcoholic beverages.

8. Some products had actually been less successful with Russian labeling, as Russian's equated Western products with higher quality. For example, Pepsi Cola's sales dropped when it labeled its products in Russian.

9. It was agreed that Baikal will hold its cash contribution until the purchase of equipment.

10. [(165 + 43) x 1,000,000].

11. These figures add up to $1.093 million, which contradict the $1.084 million total stockholders' equity amount given in the previous paragraph. The amounts are taken from the actual business plan.

12. Potato prices on the London and Amsterdam commodity exchanges ranged between $215 and $271 per ton during 1994-1995 season.

Exhibit 1

OPERATION SCHEDULE FOR THE FIRST YEAR

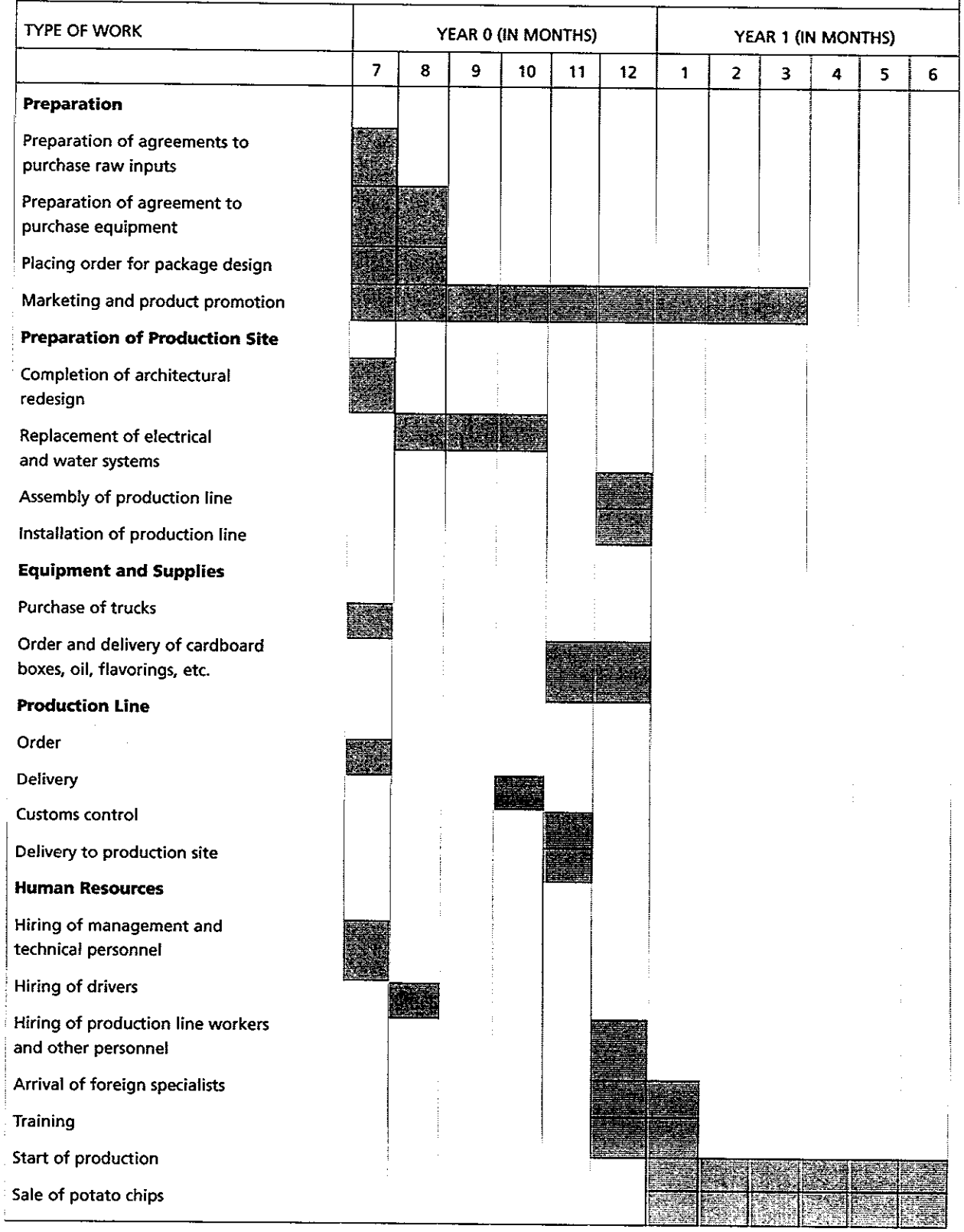


Exhibit 2

GENERAL INFORMATION

Project duration	10.5 years
Defects	5 %
Prices:	
Potatoes (VAT not included)	$196/ton
Production cost (VAT not included)	$4,125/ton
Taxes:	
Revenue tax	34%
Tariff of imported equipment	0.0%
VAT on equipment	21.5%
Equity investment in overall long-term financing structure	86%
Short-term credits	
Interest rate	30%
Term	7%
Required equity investment	$837,100

Exhibit 3

CAPITAL EXPENDITURES (in US$ thousands)

	INITIATORS	INVESTOR	TOTAL
CONSTRUCTION WORK			
Building and land			
1) Completion of architectural blueprints	2.5	0.0	2.5
2) Land and road improvement	3.0	0.0	3.0
3) Building renovation	21.3	0.0	21.3
4) Warehouse renovation	28.6	0.0	28.6
5) Additional construction expenses (heating, ventilation)	19.8	0.0	19.8
6) Total	75.2	0.0	75.2
7) Unexpected expenses (10%)	7.5	0.0	7.5
8) VAT (21% of 6+7)	17.8	0.0	17.8
9) Total for construction	**100.5**	**0.0**	**100.5**
EQUIPMENT			
Storage			
10) Sorting and control equipment	0.0	4.0	4.0
11) Dusting and spraying equipment	0.0	1.3	1.3
12) Total for storage	0.0	5.3	5.3
Production Line			
13) Washer	0.0	39.4	39.4
14) Cutter	0.0	107.2	107.2
15) Fryer	0.0	158.9	158.9
16) Heating unit	0.0	121.2	121.2
17) Control panel	0.0	52.0	52.0
18) Packaging equipment	0.0	152.0	152.0
19) Spare parts	0.0	42.2	42.2
20) Delivery and maintenance expense	0.0	50.3	50.3
21) Total for production line	0.0	723.2	723.2
22) Total for production and storage equipment (21+12)	0.0	728.5	728.5
23) Tariff	0.0	0.0	0.0
24) Delivery from port to site	0.0	2.0	2.0
25) Total (22+24)	**0.0**	**730.5**	**730.5**
TRANSPORT			
26) Trucks (2)	12.0	0.0	12.0
27) Insurance (18% of cost)	2.2	0.0	2.2
28) Total for transport	**14.2**	**0.0**	**14.2**
OTHER EXPENDITURES			
29) Office equipment	1.6	0.0	1.6
30) Maintenance and assembly fees (3 months)	13.5	0.0	13.5
31) Total for other expenditures	**15.1**	**0.0**	**15.1**
32) Total (25+28+31)	29.3	730.5	759.8
33) Unexpected expenses (10%)	2.9	73.1	76.0
34) Total for equipment (32+33)	**32.2**	**803.6**	**835.7**
35) VAT on domestic eq. (reimbursed 6 months from start of operation)	6.9	0.0	6.9
36) VAT on imported equipment (reimbursed at start of operation)	0.0	172.8	172.8
GRAND TOTAL	**132.7**	**803.6**	**936.2**

Exhibit 4

FIXED ASSET DEPRECIATION, INSURANCE, AND MAINTENANCE EXPENSE

	ORIGINAL PRICE	LIFETIME IN YEARS	YEARLY DEPRECIATION		SALVAGE VALUE	INSURANCE		MAINTENANCE	
	US$1,000		%	US$1,000	US$1,000	%	US$1,000	%	US$1,000
Building	100.5	40	2.5	2.5	75.4	1.7	1.7	2.0	2.0
Russian equipment	32.2	10	10.0	3.2	0.0	1.7	0.5	5.0	1.6
Imported equipment	803.6	10	10.0	80.4	0.0	1.7	13.7	5.0	40.2
Total	**936.3**	-	-	**86.1**	**75.4**	-	**15.9**	-	**43.8**

Exhibit 5

OPERATION PLAN

Number of shifts: 2 Number of work days in a month: 20

Number of hours in a shift: 8 Number of work months in a year: 10

YEAR	1	2	3	4	5	6	7	8	9	10	Total
First shift:											
Number of months	10	10	10	10	10	10	10	10	10	10	100
Number of work hours	160	160	160	160	160	160	160	160	160	160	1,600
	0	0	0	0	0	0	0	0	0	0	0
Second shift											
Number of months	7	10	10	10	10	10	10	10	10	10	97
Number of work hours	112	160	160	160	160	160	160	160	160	160	1,552
	0	0	0	0	0	0	0	0	0	0	0
Work hours per year	272	320	320	320	320	320	320	320	320	320	3,152
Efficiency rate	0	0	0	0	0	0	0	0	0	0	0
Actual work hours per year	0.80	0.85	0.90	0.95	0.95	0.95	0.95	0.95	0.95	0.95	-
	217	272	288	304	304	304	304	304	304	304	2,905
	6	0	0	0	0	0	0	0	0	0	6
Raw potatoes (tons)	870	108	115	121	121	121	121	121	121	121	1,162
Finished goods (tons)		8	2	6	6	6	6	6	6	6	2
Defects (5% in tons)	218	272	288	304	304	304	304	304	304	304	2,906
Finished products net defects (tons)	11	14	14	15	15	15	15	15	15	15	145
	207	258	274	289	289	289	289	289	289	289	2,760
Sales revenue — without VAT at US$4,125 per ton	854	106	113	119	119	119	119	119	119	119	1,139
		4	0	2	2	2	2	2	2	2	2

Exhibit 6

PRODUCTION COSTS

	AMOUNT	PRICE PER UNIT WITHOUT VAT, US$	TOTAL PRICE (WITHOUT VAT) US$
Variable costs for producing 1 ton of potato chips **(without defects)**			
Potatoes	4 tons	196	784
Chemicals	.25 liters	15	4
Oil	400 liters	1.25	500
Additives	20 kg	0.10	2
Packaging material	50 kg	8	400
Cardboard boxes	200	0.30	60
Electricity	800 kW	0.02	16
Total			1,766
Variable costs for producing 1 ton of potato chips **(with 5% defect rate)**			1,859
Variable costs for producing at **full capacity**: 289 tons of chips per year **(with 5% defect rate)**			537,160
Fixed annual costs			
Depreciation			86,100
Maintenance			43,800
Insurance			15,900
Utilities			
Water	10,000 cubic meters	0.01	100
Fuel	20,000 liters	0.15	3,000
Salary			
Manager	1	3,600	3,600
Accountant	1	3,000	3,000
Marketing director	1	3,000	3,000
Mechanic/electric	1	2,160	2,160
Agrarian specialist	1	2,160	2,160
Warehouse foreman	1	1,920	1,920
Sorter	2	1,680	3,360
Sales person	1	1,800	1,800
Driver	1	1,700	1,700
Manual worker (2 shifts)	2	1,440	2,880
Production controller (2 shifts)	2	1,680	3,360
Line operator	2	1,800	3,600
Packaging operator	2	1,800	3,600
Additional workers (2 shifts)	4	1,440	5,760
Total salary expense			**41,900**
Other fixed costs			
Advertising (first two years)		15,000	15,000
Advertising (subsequent years)		25,000	25,000
Training (first year)		7,500	7,500
Transport maintenance	2 trucks	1,550	3,100
Total other fixed costs			
First year			25,600
Second year			18,100
After			28,100
Total fixed costs			
First year			216,400
Second year			208,900
After			218,900
Total operating expense at full capacity			
First year			753,560
Second year			746,060
After			756,060

Exhibit 7

FINANCING (US$1,000)

YEARS	0	1	Total
Investment	961.8	-	961.8
Short-term credit (3 months)	188	-	188
Interest payment	-	14	14
Debt repayment	-	188	188
Short-term credit (4 months)	48	-	48
Interest payment	-	5	5
Debt repayment	-	48	48
Total	1,197.8	(255)	942.8

Exhibit 8

CASH FLOW PROJECTIONS (US$1,000)

YEAR	0	1	2	3	4	5	6	7	8	9	10	Total
REVENUES												
Sales	0	854	1,064	1,130	1,192	1,192	1,192	1,192	1,192	1,192	1,192	11,392
Salvage value	0	0	0	0	0	0	0	0	0	0	75	75
Reimbursed VAT	0	180	0	0	0	0	0	0	0	0	0	180
Total	0	1,034	1,064	1,130	1,192	1,192	1,192	1,192	1,192	1,192	1,267	1,1647
EXPENSES												
Management cost	43	0	0	0	0	0	0	0	0	0	0	43
Investment activities	936	0	0	0	0	0	0	0	0	0	0	936
VAT on equipment	180	0	0	0	0	0	0	0	0	0	0	180
Other expenses	0	33	8	3	2	0	0	0	0	0	(46)	0
Variable costs	0	385	480	508	536	547	558	569	581	592	604	5,360
Maintenance (Exhibit 4)	0	44	44	45	45	46	46	47	47	48	49	461
Insurance (Exhibit 4)	0	16	15	14	13	12	11	10	9	8	7	115
Utilities	0	3	3	3	3	3	3	3	3	3	3	30
Salary	0	42	44	46	48	51	53	55	57	59	61	516
Other fixed costs	0	26	18	28	28	28	28	28	28	28	28	268
Total production expense	0	516	604	644	673	687	699	712	725	738	752	6,750
Income tax	0	74	115	124	135	131	128	124	120	116	112	1,179
Other taxes	0	29	31	31	31	29	28	26	25	23	22	275
Total expenses	1,159	652	758	802	841	847	855	862	870	877	840	9,363
Net income	(1,159)	382	306	328	351	345	338	330	322	315	427	2,284
Total before financing	(1,159)	(777)	(472)	(144)	207	552	889	1,219	1,542	1,857	2,284	-
Financing (Exhibit 7)	1206	(255)	0	0	0	0	0	0	0	0	0	951
Net income after financing	47	127	306	328	351	345	338	330	322	315	427	3,235
Total after financing	47	173	479	807	1,158	1,502	1,840	2,170	2,492	2,808	3,235	-
Dividend payments	0	123	219	236	257	250	243	235	228	221	212	2,224
Earnings after dividends	47	4	86	92	93	95	95	95	95	95	215	1,011
Total	47	50	173	229	322	417	512	607	701	796	1,011	-
Repurchase of preferred stock Type A	-	-	-	-	-	-	-	-	-	-	692	692
Repurchase of preferred stock Type B	-	-	-	-	-	-	-	-	-	-	32	32
Remainder												287

Exhibit 9

INCOME PROJECTIONS (US$1,000)

YEARS	0	1	2	3	4	5	6	7	8	9	10	Total
Sales revenue	0	854	1,064	1,130	1,192	1,192	1,192	1,192	1,192	1,192	1,192	1,1392
Expenses:												
Variable cost	0	385	48	508	536	547	558	569	581	592	604	5,360
Depreciation	0	86	86	86	86	86	86	86	86	86	86	860
Maintenance	0	44	44	45	45	46	46	47	47	48	49	461
Insurance	0	16	15	14	13	12	11	10	9	8	7	115
Utilities	0	3	3	3	3	3	3	3	3	3	3	30
Salary	0	42	44	46	48	51	53	55	57	59	61	516
Management fee	0	4	4	4	4	4	4	4	4	4	4	40
Other fixed costs	0	26	18	28	28	28	28	28	28	28	28	268
Total expenses	0	606	694	734	763	777	789	802	815	828	842	7,650
Earnings before interest and taxes	0	284	370	396	429	415	403	390	377	364	350	3,742
Taxes:												
Building and property tax	0		11	12	12	12	12	12	12	12	12	115
Tax on advertising	0	1	1	2	2	2	2	2	2	2	2	18
Road tax	0	3	4	5	5	5	5	5	5	5	5	47
Asset tax	0	16	15	13	10	10	9	7	6	4	3	95
Total tax	0	29	31	31	29	29	28	26	25	23	22	275
Income before taxes	0	219	339	365	398	386	375	364	352	341	328	3,467
Income tax	0	74	115	124	135	131	128	124	120	116	112	1,179
Income after taxes	0	145	224	241	263	255	248	240	232	225	216	2,288
Interest expense	0	19	0	0	0	0	0	0	0	0	0	19
Income after taxes and interest	0	126	224	241	263	255	248	240	232	225	216	2,269
Contribution to a reserve fund (2% of revenue)	0	3	4	5	5	5	5	5	5	5	4	45
Dividend payments -Type A	0	123	219	236	257	162	160	160	160	160	160	1,798
Dividend payments -Type B	0	0	0	0	0	7	9	9	9	9	9	52
Dividend payments - common	0	0	0	0	0	81	74	66	59	52	43	374
Total dividend payments	0	123	219	236	257	250	243	235	228	221	212	2,224
Retained earnings	0	0	0	0	0	0	0	0	0	0	0	0

Troika Potato Chips (B)[1]

St. Petersburg, Russia

John Mirren was intrigued about the Troika Potato Chips proposal because it seemed to answer a market need. Three institutions planned to come together to produce the product. A farm, actually an agricultural consortium, would supply potatoes from a neighboring region; a foodstuffs distributor would distribute the potato chips in Russia's second largest city and outlying regions; and the last company would process the potato chips. Investment funds would be used to buy modern production and packaging equipment, making this potentially a very different operation in terms of volume and quality from the more usual, slow and inefficient Russian food production companies.

The financial figures looked very good, and their financial forecasts were well within the bounds of the probable — something not always true of Russian business plans. The company seemed to have almost all of the elements needed for success: sufficient storage, production and office space (finding the necessary real estate could be a real problem in Russia because ownership of property was frequently unclear or controlled by unfriendly bureaucracy), a regular supply of potatoes from within the region, an established distribution network, and modern production equipment.

But John had several reservations about the company. No one connected with the company had any experience producing potato chips. Although full training in how to use the production equipment would be provided by the supplier, this support did not prepare the founders to answer more fundamental questions. Were the potatoes the right type for potato chips? Was the quality of the potatoes high enough to justify the cost of the modern production equipment? You cannot make world-class potato chips from inferior potatoes. There seemed to be a lack of serious market research. The plans for their ad campaigns seemed a bit confused. And did the distribution network reach the sorts of stores at which potato-chip-loving consumers shopped? John was afraid that too much emphasis had been put on production and not enough on marketing. This was a common problem in Russia, a natural leftover of the centrally planned economy which emphasized production over consumer satisfaction, but a pattern which could be very harmful when launching a product that is usually a frivolous purchase. He further wondered who would control the company and provide direction? Frequently companies had internal conflicts in his experience because production-oriented executives fought with the more modern, market-oriented executives.

However, the company did have very little competition. Domestic potato chips, produced on old-equipment, were not very pleasant, and John thought the government would only increase tariffs on imported goods. He had reservations about the proposal as presented, but recognized that the company was seriously trying to address a need in the market. He wondered if he should go examine the company personally.

As he read the project summary section of the "Troika" business plan, he remembered the investment strategy of his friend Allen Dorsey, who ran a USAID backed venture fund in northwestern Russia:

I look for companies run by qualified management with a proven track-record, a product or service of incomparable quality in either the industry or the region, a clear indication of market, and project transparency. If these are in place, you may have a 70% chance of success.

NOTES

1. This case was written by Gene Gutenberg of Cornell University. It is intended as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

Aprobe, Ltd.[1]

Accra, Ghana

Main Characters

Kwadjoe Mensah: A Ghanaian with an MBA from an American university, who is also a prominent and well-connected member of the elite Accra society. Kwadjoe was popular with the American expatriates working at USAID. His knowledge of the world outside of Ghana and his memories of student life in America helped him get along well with the American community. He was a member of several professional organizations and had contacts in many industries as well as government.

J.D. Tyler: A British citizen with Ghanaian residency. J.D. was trained as a mechanic and had experience running his own garage prior to his employment in the auto industry. He was transferred to Ghana from the United Kingdom to manage the sales and distribution for a Japanese auto company. With the loss of his job, he invested $10,000 with a Ghanaian partner to start a business. This business never materialized and J.D. suspected his partner expropriated the capital. Subsequently, he chose to remain in Ghana to seek employment, where he felt his savings would go further than in England. He also had a strong belief there was money to be made in Ghana; it was only a matter of connecting with the right people.

The Pineapple Farm Aprobe[2]

Kwadjoe and J.D. arrived at the pineapple farm and pulled themselves out from Kwadjoe's Pathfinder. They were stiff from the long ride down the bumpy, unpaved road. At mid-afternoon, the sun in the tropics was at its brightest, and it was blazing hot. Bugs hovered in the thick, humid air, unable to escape the heat.

"Look," Kwadjoe exclaimed. "This field is spoiled! Ruined! All of it is ruined! The whole thing, all the fruits. See? None of them is exportable. All of them will have to go to Astro[3] unless we can get that dehydration contract from To Your Health."[4] He realized that the disappointing crop was destined to become either juice or dehydrated fruit in health food cereal.

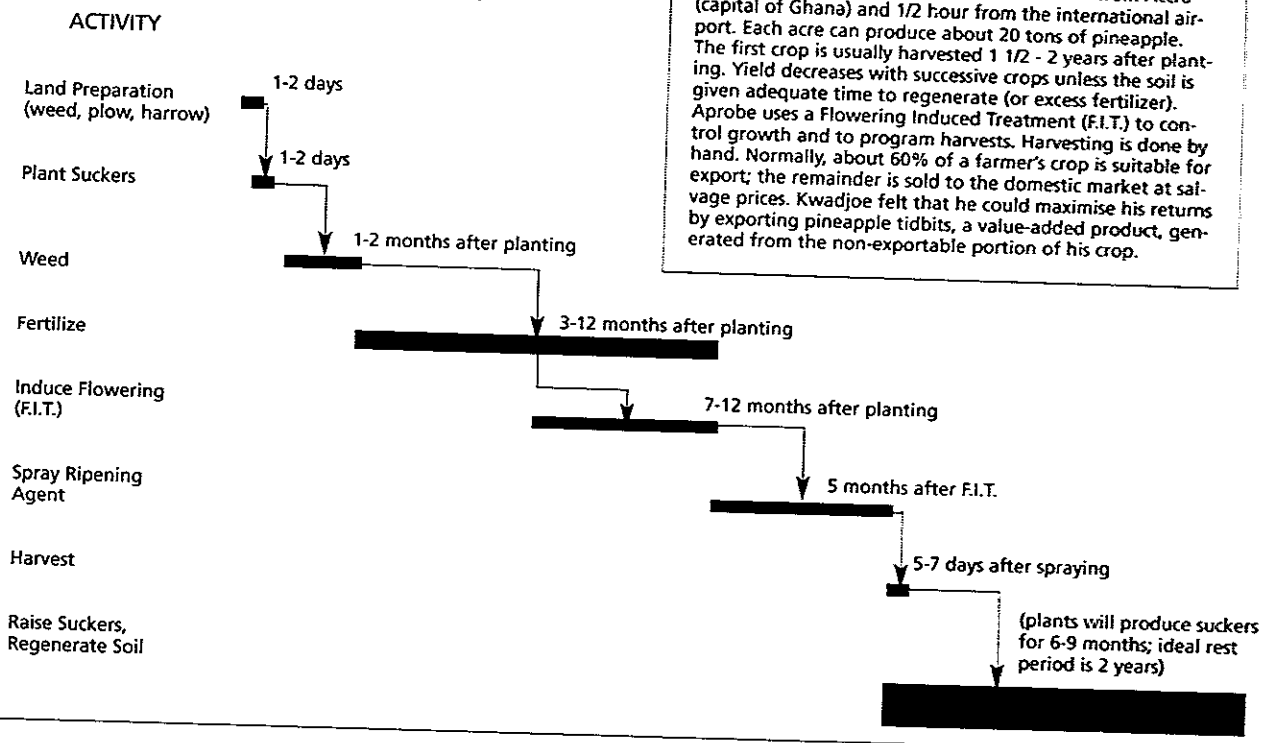
J.D., struggling to keep up with Kwadjoe, asked, "What happened here? Is this the only field you have to harvest? And where are all the workers, the field hands? I haven't seen anybody since we turned off the main road from Amasaman."[5]

The lack of field workers did not surprise Kwadjoe, since he had released most of his staff in January anticipating crop failure in May and June.[6] So for the moment he ignored his friend's questions about crops and workers and tried to think out how to deal with the situation. Kwadjoe knew he had taken a gamble over rainfall when he planted these fields. But now he was seeing up close the devastated crops and shriveled fruits, and knew they would not cover the season's operating costs. He responded to J.D.'s questions finally by explaining the dynamics of the pineapple crop cycle.

"It's like this," he continued. "When you plant pineapples, you have to balance the time between the different activities. You have to watch out for the rains and apply fertilizer after each rain. This time, we got no rain. Usually we get rain, even in the dry season. Maybe it rains once each month. This year, we didn't get

Exhibit 1

PINEAPPLE CROP CYCLE



Aprobe, Ltd. is a 600 acre farm located 25 km from Accra (capital of Ghana) and 1/2 hour from the international airport. Each acre can produce about 20 tons of pineapple. The first crop is usually harvested 1 1/2 - 2 years after planting. Yield decreases with successive crops unless the soil is given adequate time to regenerate (or excess fertilizer). Aprobe uses a Flowering Induced Treatment (F.I.T.) to control growth and to program harvests. Harvesting is done by hand. Normally, about 60% of a farmer's crop is suitable for export; the remainder is sold to the domestic market at salvage prices. Kwadjoe felt that he could maximise his returns by exporting pineapple tidbits, a value-added product, generated from the non-exportable portion of his crop.

anything. We gambled on the rains when we planted. Now all that we have are small fruits. The only thing to do is to sell them to Astro." Astro is a juice manufacturer in Accra.

Kwadjoe took J.D. to the shed to show him the farm equipment and to find the farm supervisor to make a brief introduction. Kwadjoe wanted to give his visitor a good impression of his operation, and he thought a full tour of the farm might help restore confidence. J.D. expressed his interest in the farm when they discussed the order from To Your Health, a U.K. health food store, to purchase dehydrated pineapple. They had discussed that deal when they met just a week ago. Exporting dehydrated pineapple, Kwadjoe reasoned, would introduce new food processing technology into Ghana as well as enable him to earn some hard currency. J.D. saw an opportunity for himself to get in on the ground floor of a big, international business venture.

There was more work that needed to be done on the farm than J.D. had anticipated, judging by the rusting harrowing attachment for a nonexistent tractor[7] and the soggy cardboard boxes leftover from a former customer. He considered the possibilities of a fully functioning pineapple farm and the profitable potential of being the first to export dehydrated pineapples from Ghana. As he considered these prospects, he mentally listed the improvements necessary to bring the farm up to speed with respect to harvest capabilities in fulfilling orders from the prospective client. Standing in a small piece of shade next to the shed, he gazed at the distant hills and his thoughts roamed from irrigation equipment and local labor costs to the high prices of organic produce in Europe. He speculated on the high profit of dehydrated pineapple as well as the possibility of controlling the supply of dehydrated West African pineapples to Europe. He felt the interest from To Your Health was ample opportunity to begin a profitable business. Kwadjoe and J.D. went back to the office to escape the intense heat.

Pineapple Farming and Dehydrating

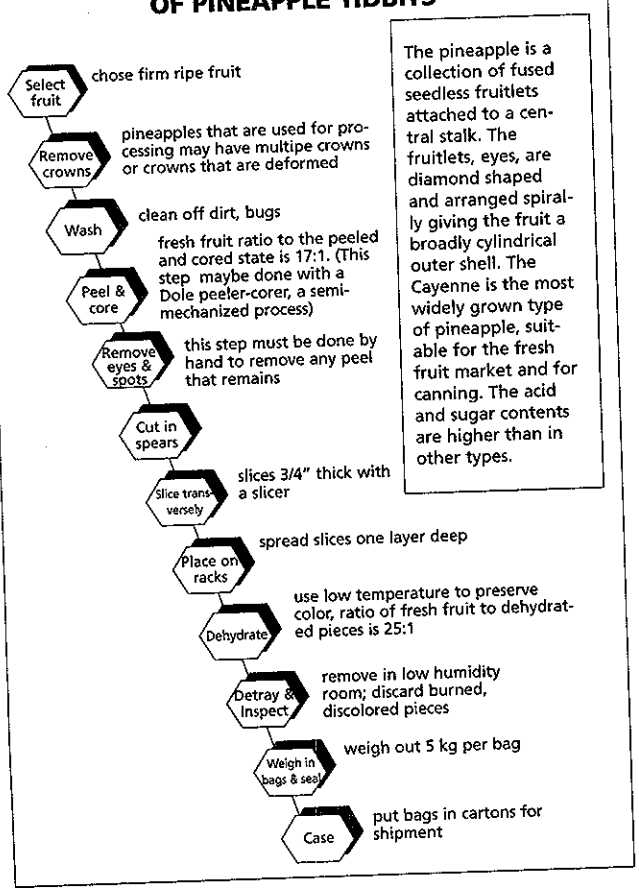
Kwadjoe began a pineapple farm in the Ivory Coast in 1987 with the proceeds of his earlier success operating an international trading company. He started pineapple farming in neighboring Ivory Coast rather than Ghana because the Ivory Coast government strongly supported agriculture and assisted farmers in finding international markets for their produce. In 1989, Kwadjoe moved his pineapple-farming operation to Ghana. Kofi, the Ivorian farm manager, transferred to Ghana to start up and run the new farm. Kwadjoe negotiated two 50-year leases for a 600-acre farm, paying one of the leases in full and agreeing to make ten-year payments on the remainder.[8] By 1992 he had become the fourth largest pineapple exporter in Ghana, a fact that made him quite proud, and he received commendations from the Ghana Export Promotion Council, the government of Ghana and even from the international aid division of

the United Kingdom. The following year, however, Aprobe faced bankruptcy, due to a default in payment by his largest customer (an illegitimate European fruit importer who took the produce but sent no payment), the inadequacy of international flights with the eruption of the Gulf War[9] and the beginning of a drought. Kwadjoe, with no money to invest in his farm or new equipment, repatriated his Ivory Coast farm manager, who noted that despite the geographical proximity of the two countries, rainfall in Ghana is significantly less than in the Ivory Coast. Kofi's last comment reminded Kwadjoe that even in the Ivory Coast, farmers can get their crops through the dry season without irrigation.[10]

In February 1994, Kwadjoe hired an English consultant through the sponsorship of the United Kingdom's international development program, working in conjunction with Ghana's trade and investment program. The consultant investigated the possibility of setting up a dehydration plant. Kwadjoe envisioned the plant as an easy way for him to earn foreign exchange by exporting dehydrated pineapple. Nonexportable fresh pineapples (about 40% of the crop) were typically sold to the local juice manufacturer or sold at salvage prices in the local market.

Exhibit 2

PROCESSING STEPS FOR DEHYDRATION OF PINEAPPLE TIDBITS



The consultant pointed out that the major source of pineapple in Britain was Central America. The fruits were slightly green at harvest, prior to a lengthy journey by sea to England. By the time they were sold in the market they had lost considerable flavor and appearance. Ghanaian pineapple growers and exporters had a competitive advantage by being able to harvest sun-ripened fruits and air freight them to Europe at a cost comparable to the Central American products. This competitive advantage was contingent upon an airline schedule with regular flights and stable rates between Accra and London.

The European market for pineapple products was relatively new, but had good growth potential. The health food market was a niche market that was projecting growth, especially for organic produce and for products prepared without preservatives. While Kwadjoe did not have an organic farm, the dehydrated pineapples were prepared without additives or preservatives. The dehydrated pineapple tidbits were tasty and appealed to a health-conscious crowd.

The consultant generated a volume of work during his six-month stay. Along the way, the project was enthusiastically encouraged by several potential customers, a finance officer and a food science research professor at the university. Based on this response, Kwadjoe ordered a pilot dehydrator from America (with financial help from USAID) to produce commercial samples and to supply small orders. Unfortunately, the dehydrator arrived the week after the consultant left, so installation proceeded without his guidance. Kwadjoe relied on local technicians to install the unit in the back room of his office space. The dehydrator operated with limited success.

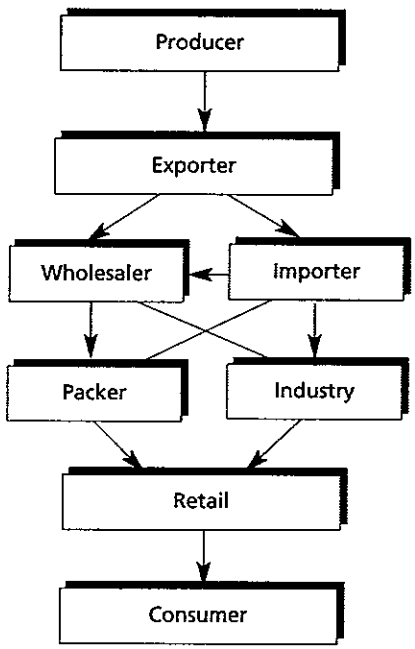
In July 1994 Kwadjoe hired a food technician to operate the dehydrator, supply the requests for samples and begin developing the dehydration project. The technician, a recent university graduate, had no practical experience and had only studied some courses in food science. He ran two tests in the dehydrator to determine the optimum production conditions. He sent dehydrated samples to some of the contacts the consultant had named and then spent most of his time reading or napping at his desk.[11]

The following October, Kwadjoe decided to follow up on the consultant's suggestions by commissioning a market survey from the American volunteer organization, IESC.[12] He hoped the survey would generate information about how to attract customers in the United States. Concurrently, he approached the development fund APDF[13] to obtain financing to build a dehydration plant, anticipating that the market survey report would attract attention and generate big orders. The APDF replied that Aprobe needed to have a letter of intent from a customer in order to apply for financing.

The market survey report concluded in January 1995 that dehydrated pineapple prices here were going to be too high to sell into the American market. Furthermore, U.S. buyers were likely to be importers, wholesalers or distributors, rather than retailers. Thus Kwadjoe's figures, based on quotes for consumer-packaged and consumer-priced dehydrated pineapple tidbits, were clearly inappropriate for planning his sales in the U.S. market.

Exhibit 3

DISTRIBUTION CHANNELS FOR DEHYDRATED FRUIT



End users of dehydrated fruits:
Largest: The dried fruit and nut industry, mixes are most popular.
Second: Breakfast cereal industry especially for muesli.
Confectionery industry (health bars, snack bars and snack foods).

Concurrently, one of the British retail contacts that had received the dehydrated pineapple sample expressed a strong interest in obtaining large orders of the product for distribution in their health food stores. They received a packet of sample dehydrated pineapple and were enthusiastic about the prospect of using dehydrated pineapple tidbits in their private label cereal and trail mix.

Pineapple Prospects

Back in the air-conditioned office in Accra, Kwadjoe and J.D. continued discussing their plans for growing, dehydrating and exporting pineapple tidbits to England for To Your Health. J.D. wanted to get some figures down on paper. He used a dehydration ration of 25:1 and a cost of fresh pineapple of ¢120 per kilo. A yield of 30 kilos of dehydrated pineapple required 750 kilos of fresh pineapple, which would cost ¢90,000.

J.D. then questioned Kwadjoe about the farm and wanted to know the yield per acre. He learned that Kwadjoe had had only 10 to 20 of the 600 acres under cultivation this past year. He also learned that Kwadjoe did not have recent financial statements; the last completed audit was 1992. J.D. felt that Kwadjoe needed a manager, and he reasoned to himself that Kwadjoe's multiple problems stemmed from a lack of organization and planning.

Exhibit 4

APROBE, LTD. FINANCIAL STATEMENTS

all costs in Cedis	1988	1989	1990	1991	1992
Balance Sheet as at Dec 31					
Fixed Assets	9061848	14362458	15131097	37346217	32914221
Development Expenditure	14348913	14365096	11894399	45278120	42476725
Current Assets					
Stocks	6400000	1000000	600000	13852658	8827921
Debtors	1049314	10405075	18653548	30410024	32508248
Bank & Cash Balance	148792	181145	5136467	67188	685434
	7598105	11586220	24390015	41329773	42221603
Current Liabilities					
Creditors	2514139	7107730	23544566	59018709	64894615
Bank Overdraft		1428952	1531557	2574838	755317
Taxation			-150500	-350500	-450500
		8536682	24925623	61243047	65199432
Net Current Assets	5083967	3049538	-535608	-19913277	-22977829
Total Assets-Current Liabilities	28494729	31777092	26489888	52711060	52413117
Creditors falling due after 1 yr	21400000	24142302	0	-43227383	33288000
Net Assets	7094729	7634790	26489888	15483677	19125117
Representing:					
Stated Capital	100000	100000	5000000	2000000	2000000
Income Surplus	-3005271	-2465210	16489888	-3516323	-874883
	-29005271	-2365210	21489888	16483677	19125117
Members Loan	10000000	10000000	5000000	0	0
	7094729	7634790	26489888	16483677	19125117

all costs in Cedis	1988	1989	1990	1991	1992
Income Statement					
Balance Beg of Yr		-3005271	-2465210	16489888	-3516323
Net Profit/Loss for the year	-3005271	540061	18955098	-10006211	2641440
Transfer to Stated Capital				-10000000	
Balance End of Yr	-3005271	-2465210	16489888	-3516323	-874883

all costs in Cedis	1988	1989	1990	1991	1992
Profit & Loss Account					
Sales	16393620	44487766	69773997	99255825	67611371
Less Cost of Sales	12780233	24929627	27335555	82124987	35235005
Gross Profit	3613387	19558139	42378942	17130838	31856366
Other Income				5758052	440000
	3613387	19558139	42378942	22889890	32296366
Less Selling & Admin Expenses	6618658	13632424	22073842	23784239	25463374
Net Operating Profit/Loss	-3005271	5925715	20305100	-894349	6833992
Interest Charges		5385654	1350002	9111862	4193552
Net Profit (Loss) before Tax	-3005271	540061	18955098	-10006211	2641440
Taxation					
Net Profit/Loss tranferred to Income Surplus Account	-3005271	540061	18955098	-10006211	2641440

Source: audited statements
Oduro-Adjyiah, Osei & Co.
Chartered Accountants

In January 1995, To Your Health requested quotes for large orders of dehydrated pineapple. Kwadjoe sent another small sample of dehydrated pineapple tidbits and indicated he was looking for an opportunity to begin production with a business partner who could contribute capital. To Your Health promptly responded via facsimile expressing an interest in an exclusive contract. However, they needed to begin receiving their supply of the product over the summer. They were

willing to pay for part of their order up-front. Kwadjoe went back to APDF with this letter hoping to begin the application process for financing a dehydration plant.

Kwadjoe learned that he needed to supply them with two years worth of financial statements and a business plan with projections for the next year. He did not have these documents. He had financial statements prior to 1993 which he thought were sufficient. His accountant got sick and died in the middle of the 1993 audit and so his work remained unfinished. Kwadjoe had not yet gotten around to hiring another accountant to finish the audit. The 1994 records consisted of a book of ledger entries, while the 1995 records consisted of a pile of receipts and entries awaiting recording as soon as Kwadjoe got around to purchasing a new ledger. As for a business plan, he operated under the belief that each sale produced revenue, and therefore earned a profit.

With the interest from To Your Health, Kwadjoe hired an accountant in February to finish the 1993 audit and undertake the 1994 audit. This accountant demanded 50% payment up front, a normal contract practice in Ghana. In March, barely scratching the surface of his work, he disappeared to Kumasi for a funeral and was gone for three weeks. By May, he completed the 1993 audit. Meanwhile, the English buyer was growing increasingly impatient with Aprobe. To Your Health offered a contact name at their bank to facilitate a loan agreement. It was now five months since they expressed any interest, and they were still waiting for the financial statements and business plan. This demand for reports frustrated Kwadjoe. He understood that the reference from To Your Health to their bank was a sign that all was well and that merely presenting his documents would move things along. But he did not understand their impatience. He simply could not send them the information they wanted because he had no 1994 audited results.

J.D. summarized his advice as follows: "What you need, Kwadjoe, is to have someone who will run this project, someone who knows something about the machinery in order to keep the pilot dehydrator in working order, and also to create enough product so you can make some sales. You will need to increase activity at the farm in order to provide ample fruits to dehydrate. Let's face it, not much is going well for you right now."

Now, in May, Kwadjoe was more than ready to quit pineapple farming and revive his international trading business. He did not want to abandon the idea of getting rich by exporting Ghanaian dehydrated pineapples, and To Your Health's interest in doing sizeable business was too good to be true. But Kwadjoe knew that it better fit his plans to go back into trading. His only problem with the pineapple business was getting a dehydration plant up and running. His recent introduction to J.D. and J.D.'s enthusiasm for the venture might relieve Kwadjoe of operating responsibilities for the farm and dehydrator, and he could then go back to trading, a business he knew well and had pursued successfully in the past. But how was he to meet the order from To Your Health before the season ended?

Appendix

Background Information on Ghana

Location

Ghana is a developing country in West Africa with its capital, Accra, located on the coast. The climate is tropical with high humidity and temperatures of 90° F or more, year round. From December to February, a dry wind blows from the Sahara, called the *harmattan*, which reduces both the humidity and visibility, filling the air with a fine, dusty silt. A slightly cooler, rainy season lasts from May through September. Annual rainfall can exceed 200 centimeters along the coast but is considerably less inland.

Ghana's population is concentrated along the coast and in the principle cities of Accra (population 1.5 million) and Chamois (500,000). The total population is over 16 million and growing at three percent annually. Approximately 45% of the population is under 15 years of age. There are over 50 ethnic groups or tribes (and languages!) in Ghana, the largest of which is the Akan. English is the official language of the country. The major religions are Christianity and Islam but a good part of the population follows traditional animist beliefs and practices.

Brief History

The name Ghana is derived from an empire that flourished during medieval times and covered what is today part of Mali, Mauritania and Senegal. In 1482 the Portuguese began trading gold in this territory. Britain later administered this area, called the "Gold Coast," as a colony from 1901 to independence in 1957. At the time of independence, the country had a substantial physical and social infrastructure, including $481 million in foreign reserves. The founder of the modern nation, Kwame Nkrumah, was devoted to Pan-Africanism and sought to further develop the infrastructure and the industrial sector. Nkrumah was overthrown in a bloodless military coup in the late 1960s. Subsequent governments have been corrupt and/or incompetent, depleting the foreign reserves and allowing the infrastructure to disintegrate.

Present Environment

Flight Lieutenant John Jerry Rawlings heads the present government, Provisional National Defense Council

(PNDC), which came to power in 1981 with a bloody coup d'etat, executing former government officials and members of the business community. At the time, business owners were dragged through the streets as exploiters. The economy subsequently stagnated, generating over $1 billion in foreign debt. In an effort to instill radical reforms, the PNDC banned political activities, confiscated property, nationalized industry, imposed a two-year curfew and imprisoned/executed citizens for political or "economic" crimes. Conditions got worse. In 1983, with the country near total economic collapse, the PNDC began to follow the IMF prescribed reforms in order to receive desperately needed foreign aid. Economic growth has since averaged five to six percent per year.

In 1992, the PNDC turned from military rule to "democracy" and reelected Rawlings. This change in government, with the blessings of the international community, buoyed foreign interest and investment in Ghana. The government was verbally committed to a market economy and continued to put state-owned enterprises up for sale, as well as its share of other ventures, according to the IMF schedule. The government reported that this program had been successful in attracting foreign investors.[15]

While Rawlings seemed to promote private enterprise, members of the business community adopted a low profile as they were unsure about the government's changing attitude toward personal wealth. The GDP per capita was approximately $500 per year. Inflation and commercial lending rates were estimated at 35% per year. The value of the Ghanaian cedi fell from ¢400 = $1 in 1992 to ¢1,000 = $1 at the end of 1994. By March of 1995, the exchange rate was ¢1,500 = $1, approximately a devaluation of 75%, or three percent per month. Business owners remained very reluctant to take out bank loans for financing.

The physical infrastructure in Ghana was difficult at best. Many minor roads were impassable during the rainy season, and the major roads which served the capital were in various stages of disrepair. There was a waiting list for telephone service which, when installed, functioned about half of the time. Cellular phone service was in high demand, but current service had been oversold and calls during peak hours were rarely completed. Customers had heard for a year that Motorola would begin offering service in the near future. Ghana had ample electrical power (from the Akosombo Dam) but the present low water levels threatened this supply. A government program was underway to carry electricity throughout the country and into villages. These plans were based on a grid system. But long delays in installing the poles and power lines left many areas of the country still without power. Most of the villages were without running water as well.

NOTES

1. This case was written by Nita Eckert of the University of Illinois-Chicago. It is intended as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

2. Aprobe (pronounced ah-pro-BAY) means pineapple in the Twi language, the most common tribal language in the region around Accra.

3. Astro is a juice company that purchases nonexport quality pineapples from farmers at ¢800/kilo.

4. To Your Health is a supermarket chain for health food and organic food in England.

5. Amasaman is a town about 20 kilometers north of Accra.

6. According to Ghana labor laws, an employer is required to pay three months of an employee's salary upon termination: labor is approximately $2/day.

7. The farm machinery was sold since the idle workers would cannibalize the equipment for spare parts to use or sell. This was a common practice for workers and a constant headache for management.

8. It is common practice in Ghana for landlords to receive full payment for a lease in advance. This puts a burden on the lessee, but it guarantees a firm price in a country where inflation and currency devaluation can be measured daily.

9. An international crisis, such as the Gulf War, devastates Third World economics. Kwadjoe noted that it took until 1995 for international carriers to reestablish air service to Ghana. These nascent services had had high profit potential before the Gulf War.

10. In 1995, rainfalls were at their lowest levels in years. In some parts of Ghana, drought-like conditions persisted.

11. A sign of underemployment, yet Kwadjoe had three full-time office employees.

12. IESC is an American volunteer organization that helps perform market studies for overseas firms.

13. Africa Project Development Facility (APDF) is a multinationally funded institution that promotes foreign investment and joint ventures. It also provides technical assistance for business plan development and project evaluation. It receives funding from many international development agencies and assistance programs that promote Third World Development.

TuTuff Equipment in Ghana[1]

Accra, Ghana

It was a Friday night, the last night of the Ghana International Furniture Exhibition (GIFEX '95), an event that brought together the Ghana timber industry with foreign equipment manufacturers and investors. There was growing demand worldwide for tropical hardwoods, and the show in Ghana **(GIFEX)** had grown considerably over previous years. A lot of new players were now interested in the Ghana timber industry.

Hugh Smith of TuTuff Equipment (TTE), an American manufacturer of timber processing equipment, came to the exhibition to introduce his line of goods into Ghana. Smith believed he had the best product in terms of quality and price, but he knew it was a difficult market to sell in. Sales depended on the availability of flexible credit, something he could not afford to offer his customers. His European competitors were even resorting to barter to move their product. Smith wanted to find a workable method to boost his exports by helping customers finance their purchase of his equipment.

Godfried Evans of Commonwealth Finance (CWF) (UK) represented private investors with interests in providing venture capital financing for developing markets. Evans believed Ghana's changing economy and government would provide good investment opportunities for his firm, particularly in the areas of merchant trade finance and investment.

Michael Anaba of ABK Timber Trading (ABK) (Ghana) had hoped to find an investor to finance his teak milling project. He wanted to forward integrate his logging operation into furniture manufacturing, and he knew that the very attractive equipment displayed at the trade show would allow him to do it. The majority of timber merchants in Ghana exported teak poles to Indian firms, where they were processed into finished goods for re-export to Europe and Asia. After nearly ten years of exporting unprocessed teak poles from Ghana, Anaba wanted to expand his operation into teak milling and produce a value-added product. Unfortunately, he did not have the capital to finance the equipment he would need, so he sought financing to purchase new equipment.

At the Aquarium Bar in downtown Accra, these three men met at the end of the conference day to explore a possible business venture.

Evans opened with, "Well then, as I understand it, you, Mr. Anaba, want to purchase this milling equipment in order to manufacture furniture, and you, Mr. Smith, want to sell the equipment to him. As you both know, my company, Commonwealth Finance, has recently established the Ghana Growth Fund (GGF). We have been looking at investment opportunities such as this for some time now. I must say, though, Mr. Smith, it is unfortunate you are leaving Sunday."

Smith responded, "Yes, it is unfortunate, but understand, I came here to seek new market opportunities for my company, TuTuff Timber Equipment. We have been here for over two weeks now at GIFEX, and have had inquiries from more than 70 companies and spoken to over 10 of them. We've found that only ABK Timbers instills any confidence, which is why I'm interested in what may come out of this meeting. TuTuff takes a long-term view of its expansion into Africa, and that is why we are ready to provide installation and training.

Exhibit 1

ABK PROPOSAL JOINT VENTURE (JV) STRUCTURE

ABK Timbers proposes to form a joint venture for the production of milled teak furniture components. The JV will purchase teak poles from ABK. The JV will utilize the existing empty shed and the administrative building at ABK's sawmill to erect a woodworking shop. The poles will be milled into planks utilizing the existing bandmill at ABK's sawmill. The planked teak poles shall be further milled into furniture components on the JV's new equipment. The components will be jointly marketed in Europe. Based on the current supply of teak poles, initial production is estimated at 72 cbm per month (four 20-foot containers).

The potential JV partner shall invest equipment and technology (training) as follows:

Quantity	Description	Unit Price in U.S.$	Price
2	chemical sprayers and tanks	$ 1,000	$ 2,000
1	edger	5,000	5,000
6	table saws	4,000	24,000
3	cross cutters	1,500	4,500
2	sharpening gear	1,000	2,000
4	solar kiln driers (18 cbm)	8,000	32,000
6	planing machines	3,000	18,000
2	fork lifts, 2 tons each	10,000	20,000
3	monorails	1,500	4,500
		Subtotal	$112,000
Working capital			50,000
Technical training and marketing assistance			10,000
Total contribution		Total	US$172,000

ABK shall provide its existing assets as payment "in kind":

3 acre	land	60,000	$ 60,000
14,400 sq.ft.	open shed	30,000	30,000
2,400 sq.ft	administrative building	22,000	22,000
1	vertical bandmill	10,000	10,000
various	office furniture for staff of 5	5,000	5,000
1	telex	1,500	1,500
1	facsimile machine	1,500	1,500
1	telephone	1,000	1,000
1	4x4 jeep	25,000	25,000
2	cars	8,000	16,000
		Total contribution	US $172,000

Income tax loss carry forward	5 years
Accelerated depreciation for two years for plant equipment	50%
Accelerated depreciation for five years for building and land	20%
Income tax on nontraditional exports	8%
Income tax rebate for location	25%
Import of equipment is duty free	0%

But it is difficult to justify returning to Ghana, halfway around the world, to invest more time and money without at least one confirmed order from the GIFEX show."

Anaba said, "But sir, you have an order, a large order. You know my project proposal, and you know there is a great demand for milled teak. It is you who are insisting on advance payment. All ABK is asking for is terms of credit."

Smith said, "Ghana seems to be the best opportunity for expansion into West Africa, and I am flexible and committed to the market. I know that the price of teak has been constant for the past five years and can only go up. Yet, until we have established relationships in Ghana, we can only accept orders with a confirmed irrevocable Letter of Credit."

Evans interjected, "Gentleman, I believe that is why you've asked me here. If this project is indeed viable, and by that I mean economically sound and fiscally prudent, we will find a method satisfactory to all, and the GGF will finance it. Mr. Anaba, I would be interested in seeing your company's financial statements, the project proposal, and any other available data."

Anaba shared two pages with both men: "ABK Proposal JV Structure" (Exhibit 1) and "ABK Proposal Financial Projections" (Exhibit 2). He further provided Evans (but not Smith) with a page entitled "ABK Financial Statements"(Exhibit 3).

He turned to Smith to continue the conversation with another line of questioning: "Mr. Smith, perhaps your company is interested in investing in Ghana or forming a joint venture to market milled teak in the United States or elsewhere? Maybe you have a customer who can provide specifications for his product, place an order and thereby guarantee payment for the equipment utilizing an escrow agreement? What if . . ."

Smith was uncomfortable with these suggestions since they asked that he make arrangements that went well beyond his already very full role as export manager,

Exhibit 2

ABK PROPOSAL FINANCIAL PROJECTIONS

JV projections to produce four 20' containers of milled teak furniture components: (the following figures are based on ABK historical data and industry standards; one 20-foot container holds 18 cubic meters.)

Purchase price of (discounted) teak poles from ABK Timber/cbm *	175
All Costs Include Estimated Labor Rate and Power Consumption	
Cost to treat teak poles for resistance to fungus, insects, etc.	5
Cost to process teak poles into planks at ABK sawmill/cbm	10
Cost to process teak poles into lumber/cbm (estimated)	9
Cost to process lumber into strips/cbm (estimated)	15
Cost to process strips into components/cbm (estimated)	7
Cost to process components into furniture parts/cbm (estimated)	12
Cost to process furniture parts into kiln dried parts/cbm (estimated)	2
Approximate Yield from Teak Pole to Furniture Component	33.3%
Selling price of teak furniture components/cbm	850
Cost to pack container and transport container from mill to port/cbm	30
Approximate direct administrative and port handling charges/cbm	10
Assume a Contract for Four 20-Foot Containers (18 cbm each)	
Approximate total selling price	61,200
Approximate total cost	53,640
Approximate (Monthly) Gross Profit	**US$7,560**

Salaries for administrative officers are negotiable.

* cbm = cubic meter volume

Exhibit 3a

ABK TIMBERS, LTD.
PROFIT AND LOSS STATEMENTS
1990 - 1993
(THOUSANDS OF CEDI)

	1990	1991	1992	1993
Gross sales	103,354	28,395	75,215	145,845
Less operating expenses	78,678	34,659	93,433	134,164
Cost of sales	58,303	43,861	40,366	93,943
Selling & administration expense	136,981	78,520	133,799	228,107
Net operating income	(33,627)	(50,125)	(58,584)	(82,262)
Other income	8,667	148	1,061	325
Income taxation	0	0	0	0
Transfer to income surplus	(24,960)	(49,977)	(57,523)	(83,937)

Exhibit 3b

ABK TIMBERS, LTD.
BALANCE SHEETS
YEAR END SUMMARY
(THOUSANDS OF CEDI)

	1990	1991	1992	1993
Fixed Assets				
Plant and equipment	27,101	21,723	15,784	11,866
Deferred capital expenditure	2,650	1,987	1,325	662
	29,751	23,710	17,109	12,528
Current Assets				
Stocks	0	51,000	13,800	128,499
Accounts receivable	223,036	225,801	227,724	277,855
Bank & cash balances	4,686	4,90	5,911	7,981
	227,722	281,706	247,435	414,335
Current Liabilities				
Bank overdraft	4,857	16,594	2,000	127,152
Accounts payable	222,355	230,517	245,358	333,445
NPART fees (taxation)	903	853	653	653
	228,115	247,964	248,011	461,250
Net Current Assets	(393)	33,742	(576)	(46,915)
	29,358	57,452	16,533	(34,387)
Deferred Liabilities	(165,113)	(243,184)	(250,036)	(270,853)
Net Liabilities	(135,755)	(185,732)	(233,503)	(305,240)
Represented By:				
Stated capital	11,000	11,000	11,000	11,000
Income surplus account	(146,755)	(196,732)	(244,503)	(316,240)
	(135,755)	(185,732)	(233,503)	(305,240)

Exhibit 4

ABK OPERATIONS
TEAK HARVESTING-LOGGING OPERATION
(ABK CURRENT COST OF EXISTING OPERATIONS)

This analysis reflects operations conducted using subcontracted labor and equipment in an existing plantation. Concession rent and property mark are paid, roads and dumps are constructed, and the analysis does not include indirect costs of administration, rent/utilities, security, etc.

Estimated Volume of Production (average over one month)

Number of working days per month, excluding taboo and holidays		21 days
Number of poles hauled to siding, using 1 tractor (25/day)		25 poles
Poles produced in 21 days		525 poles per month
Cubic meter volume (cbm) of poles produced, Each pole measuring an average 0.4 cbm per pole	(525 x 0.4 cbm)	210 cbm per month

Estimated Cost of Production: cedi=¢	**ESTIMATE**	**TOTALS**
Cost of pole (incl. royalty) @ ¢16,000 each	(525 x ¢16,000)	8,400,000
Felling and cross cutting	(525 x ¢1,500)	787,500
Haulage to siding	(525 x ¢2,500)	1,312,500
Loading at siding	(525 x ¢3,000)	1,575,000
Transport from plantation to depot		
30 poles per truck per trip	(18 trips x ¢700,000 for hired truck)	12,600,000
Unloading poles at Tema Depot	(525 x ¢2,000)	1,050,000
Measurement expenses-fee and labor	(525 x ¢190)	99,750
Measuring expenses-FPIB officials	(210 cbm x ¢65)	13,650
Loading poles at Tema Depot for port	(525 x ¢3,000)	1,575,000
Transport to port	(18 trips x ¢80,000 for hired truck)	1,440,000
Port charges, etc.	(210 cbm x ¢4,000)	840,000
Total		¢29,693,400

Estimated Income		
Export proceeds @ US$215/cbm F.O.B.	(210 cbm x US$215)	US$45,150.00
Less fees and bank charges, total 5%		US$2,257.50
		US$42,892.50

Estimated Net Proceeds		
Net proceeds in cedis @ ¢1050=US$1.00	¢ 45,037,125	
Deduct total cost		¢ 29,693,400
		¢ 15,343,725

NOTE:	Market exchange rate of cedi	¢1,200 / US$1
	Bank exchange rate	¢1,050 / US$1

responsible for marketing his firm's equipment to different parts of the world. Evans, meanwhile, wanted to scrutinize the documents more carefully before committing himself further. He said, "Perhaps. Well, I think it best that we call it a night, and plan to meet here for lunch at noon tomorrow. We can continue this discussion after a good night's sleep. Let's see what we can come up with tomorrow."

Anaba kept his summary of "ABK Operations" (Exhibit 4) to himself, sharing it neither with Evans nor Smith. All three headed to home or hotel room in anticipation of the next day's meeting.

Commonwealth Finance, Ltd.

Commonwealth Finance, Ltd. was a U.K.-based financial investment and consultancy firm specializing in trade finance and project development in the former British colonies. It was chartered as a merchant bank in Ghana in June 1994 and began operations in Accra in January 1995. It had recently launched the Ghana Growth Fund, a private closed-end fund, to invest in energy and infrastructure development projects in the country, and to support the growth of nontraditional exports.

The GGF could engage in currency and commodity speculation, trade in stocks and bonds, provide project financing and act as a venture fund taking an equity position in new business ventures. The GGF did not act as a trading company or broker the import or export of goods. When the GGF financed a project, it placed strict conditions on the use of the loan. When the GGF took an equity position in a new venture, it brought in new management when necessary. The GGF was capitalized at US$40 million.

The target requirements for GGF investments were a minimum outlay of US$200,000, a 20% annual return (in U.S. dollars), and a payback period of five years.

Evans, a U.K. national, was managing director of GGF. Based in Accra since January 1994, he courted many important actors in the political and economic circles of Ghana, which often overlap. Evans was a financier and a "people person." Prior to this week, he had never met Anaba, but he had heard of him many times. Other people had informed him that Anaba was a major player behind the scenes in political and economic developments of Ghana since its independence. He managed—to the chagrin of many—to maintain a position of importance throughout Ghana's various military and civilian regimes. Yet with the passage of time, his role had largely diminished to that of elder statesman and struggling entrepreneur.

The Government of Ghana was expanding its Divestiture Program, and a number of potentially viable state-owned enterprises (SOEs) were to be privatized in the coming years. Evans was particularly interested in some of the companies located in Anaba's traditional (tribal) area. He anticipated that there might be some "irregularities" in the sale of these assets (all in the name of expediency, of course), and therefore he was willing to forego the usual stringent requirements of the GGF in order to befriend Anaba. He viewed relaxing the GGF requirements for the ABK deal as a "loss leader" to gain access to some interesting investment opportunities likely to materialize in the future.

Evans wanted to study ABK's past financial performance and review the marketing plan. If convinced of the managerial competence and the marketability of the finished product, Evans would finance the project with a revised target of a minimum US$100,000 investment, a ten percent per annum return, and a payback period of one and a half years. This payback period was shorter than usual due to the risk of the NDC government losing the 1996 election and Anaba's influence fading in a new government.

TuTuff Timber Equipment, Inc.

TuTuff Timber Equipment, Inc. was an Oregon-based, U.S. manufacturer and distributor of equipment for the industrial timber and wood-working industries. TuTuff was founded in 1973, and the TuTuff brand name was well known in the United States and Canada. From 1973 until 1981 TuTuff's business grew at an average of five percent per year. From 1981 to 1986 sales were flat, and then they began to decline. TuTuff blamed this on the "green movement" and spotted owls. In 1986 annual sales peaked at US$8.5 million.

In 1987 TuTuff hired Hugh Smith as Export Manager. That year it also participated in a trade show in Miami, which generated a $200,000 order for milling equipment from Belize. TuTuff quickly learned that exporting required much more work than simply shipping goods, after its client in Belize sent a telex indicating that their new TuTuff equipment would not work. Smith flew down to Belize the next day, only to discover that the electric power fluctuated too much, and that a US$200 voltage regulator would be required to remedy the problem.

In 1988 TuTuff established a branch office in Miami to market products in Latin America. After the Belize experience, TuTuff spent considerable energy identifying local sales representatives who could be trained to provide the after-sale service required. Exports to Central and South America grew strongly and now accounted for 20% of annual revenue.

In 1994 TuTuff annual sales topped US$10 million. Flush with its initial success in the export market, TuTuff decided to expand into other regions. TuTuff determined that it would be most competitive in West Africa.

The company was confident that the quality of its products and competitive pricing would enable it to establish a presence in the region. TuTuff decided to enter the region by launching its product line in Ghana.

Smith was aware that Anaba was a traditional ruler (e.g., a chief of his tribe), but he was unaware that good relations with him could be an asset, providing an introduction (and an informal recommendation) to the political and economic leaders of Ghana. Smith previously accepted export orders only with an irrevocable confirmed Letter of Credit and saw no reason to change that policy.

TuTuff was not interested in importing or exporting timber, and viewed taking an equity position or managing a logging or milling company as a conflict of interest. The company was willing to introduce ABK to importers of tropical hardwoods in the United States and Canada, provided TuTuff was not asked to negotiate on behalf of the exporter or to attest to the quality of the product.

ABK Timber, Ltd.

Anaba described himself as a self-made man of humble origins. He managed to survive and thrive as a successful businessman and behind the scenes actor through Ghana's various military and civilian regimes. He demonstrated great political acumen but lacked the foresight to estimate the effects of the recent liberalization of the economy. All of his business interests were devastated by the devaluation of the cedi, removal of subsidies and the introduction of competition.

ABK was founded in 1984 by Anaba as a traditional logging company. This was Anaba's fifth company and his first in the timber industry. In 1985 ABK acquired a concession of 60 square miles and obtained a loan of US$200,000 through a government-administered loan facility. This money was used to purchase logging equipment and establish a sawmill for the production of boules (semi-processed logs) for export to Germany.

Various factors, including a temporary ban on the export of certain lumber species, the breakdown of production equipment and labor problems, forced the company to suspend operation in February 1988. A year later, the company made efforts to rehabilitate the old or broken equipment and renegotiate its loan with the government. Subsequently, Ghana's government, through its Non-Performing Assets Recovery Trust (NPART), assumed ABK's outstanding commercial debts and established a repayment scheme for these deferred liabilities.

In 1990 logging operations resumed, and the company made contacts with overseas buyers. In 1991 the company ventured into teak pole production for a contract of 4,000 cbm (cubic meters) valued at US$1 million. Two months into production, however, ABK's customer and Letter of Credit disappeared with the sudden collapse of the Bank of Credit and Commerce International.

Aware that the government of Ghana banned the export of teak poles in 1979, Anaba was concerned about recent efforts to enforce this ban. From time to time, the government granted special exceptions to this ban, but Anaba believed the government would soon enforce a ban on all round log exports in order to promote industrialization. Environmentalism was not a factor in this policy. Processed wood would still be eligible for export.

Anaba chose to concentrate his efforts on acquiring new machinery and technology. He attempted to form two different joint ventures in the past year, but both potential partners backed out after being requested to invest money for working capital. Even though all ABK exports were priced in U.S. dollars, ABK was obliged to convert its foreign exchange into cedis at the time of sale.

Anaba wanted to produce garden furniture, and he was now trying to acquire the needed equipment to do it independently. At GIFEX he was quite impressed by the TuTuff product line and felt that the price level was reasonable. He wanted TuTuff to provide technical assistance and training to his staff so that he could meet the technical requirements and quality demanded by importers. He also wanted TuTuff to assist in marketing the finished products. ABK was unable to finance the acquisition of new equipment from its own working capital, and it further was unable to obtain financing through the commercial banking system.

Luncheon Negotiation

The next day, the three men met for lunch to discuss the JV Proposal. They each had taken time to reflect on the risks and benefits of the venture as presented on paper, and they now had to decide if the proposed deal was worth pursuing.

QUESTIONS FOR DISCUSSION

(1) What would you advise each of the three men—Anaba, Evans and Smith—to propose at their meeting? (Be prepared to play the role of one of these people.)

(2) How would you evaluate the materials provided by Anaba? Is this an opportunity CWF should invest in?

(3) If the three men decide to move ahead with the deal, what problems should they anticipate and how should they manage them?

(4) How should TuTuff develop its sales effort in Ghana and other parts of West Africa? How should it structure its relationship with other potential buyers of TuTuff equipment?

Appendix A

BACKGROUND ON GHANA

Geography

Ghana is a West African country, situated on the Gulf of Guinea, rich in both natural and human resources. Accra, its capital, is four degrees north of the equator and is located on the sea near the zero meridian. Ghana covers 238,540 square kilometers (about the area of Oregon), and is bordered on the west by Cote d'Ivoire, on the north by Burkino Faso and on the east by Togo. The Volta Lake, the world's largest manmade lake (8,900 square kilometers), extends from the Akosombo Dam, providing a source of hydroelectric power to most of Ghana.

Climate

Ghana's climate is tropical, with temperatures between 21°C and 32°C. The rainy seasons extend from April to July (heavy) and from September to November (light), exceeding 200 cm at the coast annually. Southern Ghana is humid year-round, and the north is very dry. It is coolest from May to October. During December the *harmattan*—a dry dusty wind from the Sahara—covers the country and lasts through February, reducing visibility with clouds of dust.

Population

Ghana's population is estimated at 18 million, with an annual growth rate over three percent. The majority of Ghanaians belong to one of four broad ethnic groups: Akan (43%), Mole-Dagbane (14%), Ewe (13%) and Ga-Adangbe (8%). Many subgroups exist, along with many other smaller ethnic groups. There are also small communities of foreigners, including Lebanese, Syrian, Indian and Chinese. These groups of immigrants to Ghana now dominate the formal trade and retail sectors. English is the official language of Ghana, which is inherited from British colonial rule, and most urban Ghanaians speak some English. Twi (Akan) is the unofficial second language out of about 100 other ethnic languages. Approximately 33% of the population is Christian, 33% is traditional animists and 33% is Muslim. Religious and ethnic strife is rare.

History

Ghana obtained its independence from British colonial rule in 1957, under the leadership of Kwame Nkrumah (pronounced "nick-ROOM-ah") and the Convention People's Party (CPP). A parliamentary democracy was established, but Ghana was soon transformed into a single-party, socialist state. Nkrumah was overthrown in a coup in 1966. A series of corrupt and ineffective military and civilian governments exchanged power until December 31, 1981, when Flight Lt. J.J. Rawlings led his second coup, establishing the Provisional National Defense Council (PNDC).

The PNDC courted Cuba, Libya and the U.S.S.R. For two years the PNDC banned all political parties, confiscated property and imprisoned or even executed citizens for political or economic crimes. In 1982, in the midst of severe drought, the forced repatriation of nearly one million Ghanaian workers (who were expelled from Nigeria) and yet another unsuccessful coup attempt, the economy verged on collapse.

Recent Developments

Beginning in 1983, the government recognized the need for radical economic reform, and performed an abrupt about face. Ghana accepted the advice of international organizations such as the World Bank, the International Monetary Fund and donor agencies and implemented the Economic Recovery Program (ERP). In 1987, the Structural Adjustment Program (SAP) began, involving privatization of state-owned enterprises (SOE). The Rawlings regime began to implement political reform as well. The PNDC became the National Democratic Congress, and other political parties were allowed to form as well. This process culminated in April 1992 in Ghana's adoption of the Constitution of the Fourth Republic of Ghana. On November 3, 1992, Rawlings was elected President under international supervision. This political and economic "miracle"—this transformation of Ghana—was financially supported throughout by donor states and international organizations. By 1994 Ghana had become the fourth largest recipient of U.S. foreign aid.

Current Economic Situation and Trends

According to a 1993 report by the American Embassy in Accra, "The national tendency to link conspicuous business success with corruption has caused many entrepreneurs to adopt a low profile in their business dealings and to integrate business operations horizontally rather than vertically, to avert the attention of tax auditors and public tribunals charged with adjudicating economic crimes against society."

Ghana has enjoyed impressive growth rates—fueled partly by international donor assistance—of 4.5% per annum on average in recent years. Spurred by the U.S. Agency for International Development Trade and Investment Program and other aid and donor groups, the government of Ghana has encouraged the development of nontraditional exports. Traditional exports include cocoa (Ghana is the leading producer in the world), gold (fifth largest in the world) and timber (sold as unprocessed round logs). A stock exchange has been opened in Accra; to date 17 companies are listed, one jointly in London, Ashanti Goldfields, Ltd.

According to the U.S. Embassy in Accra, a total of 13 commercial, merchant (investment) and so-called

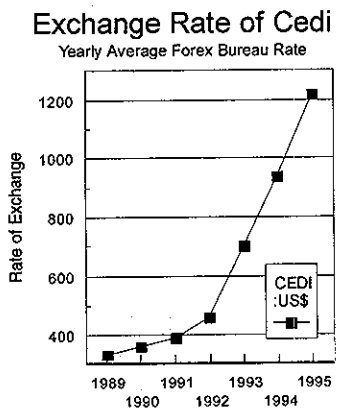
Exhibit A-1

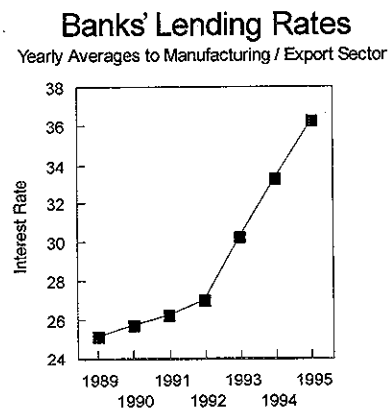
GHANA ECONOMIC DATA

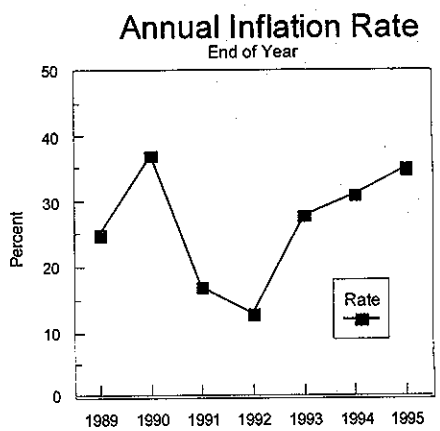
(cedi is currency in Ghana) Economic Measure

	1990	1991	1992	1993	1994	1995
Nominal exchange rate of cedi : U.S. dollar	360	390	460	700	940	1220
Annual lending rate of commercial banks	25.75%	26.25%	27%	30.25%	33.25%	36.25%
Annualized inflation rate in Ghana	37%	17%	13%	28%	31%	35%

Source: Compiled through interviews with Bank of Ghana, commercial lenders and money changers.







development banks are chartered in Ghana of these; eight are state owned. The banks tend to invest in high-yield government treasury bills (currently paying 33% interest), commercial paper and short term (180 day) import financing. Capital financing for equipment purchase or factory rehabilitation is considered less profitable and more speculative.

Ghana's Infrastructure

Ghana has two ports, one in Takoradi, built by the British, and one in Tema, built by Nkrumah. Tema is now an industrial center, and the government is experimenting with the implementation of bonded warehouses, export processing zones and a free port at Tema. Ghana has approximately 20,000 miles of main roads; about one-third are paved. Secondary and feeder (tertiary) roads are difficult to maintain and often become impassible in the rainy seasons due to mud flows.

Appendix B

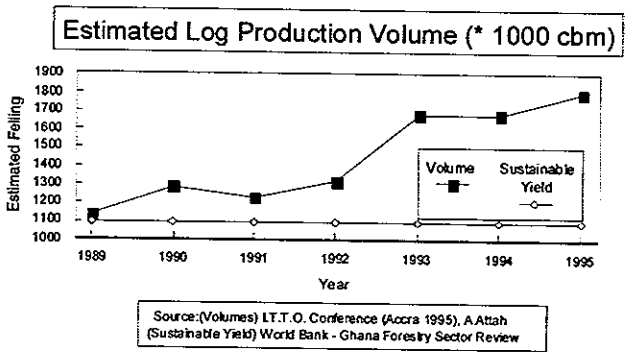
BACKGROUND ON THE TIMBER INDUSTRY

The Ghana timber industry is in a chaotic state. The government arbitrarily imposes and lifts restrictions on the felling of trees or the export of certain species. It has been accused of awarding temporary monopolies on the export of round logs, and has proven ineffective in regulating or controlling the illegal felling of timber for the local use market. In the 1980s, the UN-FAO, British ODA and the World Bank financed the Forestry Inventory Project in conjunction with the Ghana Forestry Department and the Timber Export Development Board (TEDB). The purpose of the project was to determine a sustainable yield for the industry. It measured activity in protected reserves, and determined the following:

Total increment for high forest	4 cbm/hectare/year
"Official" estimated annual cut	1.25 cbm/hectare/year
Total production working circle area	1.16 million hectares
Therefore total increment at 4 cbm/hectare/yr	4.6 million cbm/year
Permitted annual cut at 1.25 cbm/hectare/yr	1.4 million/sq.m/year
Safe allowable cut World Bank Forestry Sector Review	1.1 million/cbm/year

Source: Ghana Hardwoods Trade and Industry Directory, TEDB, 1991.

According to the U.S. Embassy in Accra, deforestation has reduced forest land from 8.2 million hectares around the year 1900 to about 1.7 million hectares today. This fact and the data above have influenced the



government to attempt to enforce its bans on the export of round logs.

Forest Sector Agencies: State institutions in the forestry sector by type of activity:

Institution/Agency	Activity
Ministry of Lands & Forestry	Sector ministry
Timber Export Development Board	Trade promotion & development
Forest Products Inspection Bureau	Inspectorate and contract vetting
Forestry Department	Resource management/ administration
Forestry Commission	Policy formulation/ implementation
Forest Research Institute of Ghana	Forest and forest industry research
Institute Renewable Natural Resources	Training and manpower development
Department of Game and Wildlife	Resource conservation/ management

Source: A. Attah, "Developments in the Timber Trade," International Tropical Timber Organization Conference (Accra 1995).

Prior to commencing operations in a forest reserve concession, a logging company must renew its property mark. All logs felled are required to be marked accordingly and a Log Inspection Certificate (LIC) must be prepared by the Forest Products Inspection Bureau. Prior to export, a company must obtain the approval of the Timber Export Development Board. A transaction fee of one percent is levied by the FPIB and another two percent by the Timber Export Development Board, totaling three percent of the value of approved export contracts.

Ghana has made efforts to promote value-added production and industrialization by classifying processed timber as a nontraditional export, subject only to an eight percent income tax on export revenue. Ghana has empowered the Forest Product Inspection Bureau (FPIB) to halt trucks leaving plantations and forest reserves to inspect all logs felled to ensure they are properly documented. Ghana has further empowered the Timber Export Development Board to advise minimum price levels and/or deny export permits when operators seek approval of their timber export contracts.

The Structure of the Timber Industry

The present structure of the industry can be classified according to three categories of operations: primary (logging), secondary (saw and veneer milling) and tertiary (furniture parts, etc.).

The majority of logging companies in the industry are small—three to five people—and they act as contract workers to sawmills. The assets of these companies typically include little more than a chain saw or two. These individuals are highly mobile and the government has been completely ineffective at regulating their activities. This was best exemplified by the lumber available in the local wood markets, typically at a steep discount. That lumber usually was not cut at a sawmill; rather, it was "milled" in the forest by a chain saw.

Firms can be categorized by wood processing activity:

Type of Activity	# of Firms
Logging	250
Saw milling	110
Ply milling	9
Veneer milling	15
Chipboard manufacture	1
Furniture manufacture	40
Flooring	6
Doors	4
Profile boards/molding	12

The industry is characterized by many small indigenously-owned enterprises. Five are state-owned enterprises (SOEs), which are large integrated companies that account for about one-third of Ghana's officially recorded timber exports.

Source: ITTO Conference, Accra, 1995.

Logging Period

Forest concessions are located in areas where the rainy season extends from March to August. During this period, the operations of felling, hauling and transporting logs is successful sporadically. The work period may be calculated as follows:

Calendar year	365 days

Taboo days and official holidays	(63)
Total working days	302
Days of rain/month, 2-4 over 8 months	(24)
Days of rain/month, 5-8 over 4 months	(26)
Total working days without rain	252
Average number of working days per month over year	21

Land Uses and Administration

Officially logging operations occur in three areas: protected reserve, open forest and unreserved forest.

- Forest reserves are legally defined and demarcated areas, and are subdivided into compartments of approximately one-half square mile (1.3 sq. km.). The Forestry Department conducts a stock survey and determines the yield to be offered to the concessionaire when the timber is ready to be harvested.
- Open forest is forest/agricultural lands that are under the jurisdiction of the Ministry of Lands. Logging activity conducted on these lands is subject to negotiation with village representatives.
- Unreserved forest is also under the Ministry of Lands, but is administered by the "Stool's Land" Service (a government body that upholds the rights of traditional rulers, such as chiefs).

Logging Plan

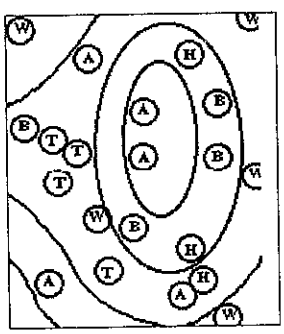
Prior to operations, the concessionaire must produce a logging plan:

A. Contoured Survey Map on a scale of 1:50,000:

1. concession boundary detailing area in km²
2. compartment number in concession site
3. productive and protective working areas
4. indicate types of trees
5. location of water and course of flow
6. haulage roads
7. major skid tracks
8. log dumps
9. refuse sites

B. Felling sequence of harvesting operation

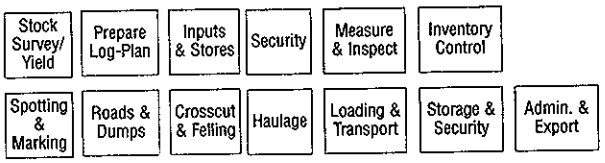
1. application for renewal of property mark



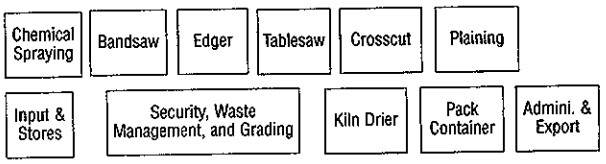
Source: Forestry Department, Logging Manual, 1992

Logging and Milling Production Flow Chart

The first phase produces teak poles and round logs:



The second phase produces milled teak furniture components:



NOTES

1. This case was written by Christopher Shyers of American Graduate School of International Management (Thunderbird). It is intended as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

Caisse d'Epargne de Madagascar (CEM)[1]

Anatananarivo, Madagascar

Determined to achieve his goal of privatizing the National Malagasy Postal Savings Institution (la Caisse d'Epargne de Madagascar, or CEM), its general director, Paul André Andriamamonjisoa,[2] continued to demand improvements from his staff and himself. The organization was in the midst of the biggest change in its history—from a manual savings operation into an automated full-service bank—and much had to be done to keep things on track. Paul André's vision was clear, but making it a reality required the committed efforts of many people. He had called a meeting of his key managers that morning to better coordinate their collective efforts.

The Caisse d'Epargne as a Potential Bank

In 1993, the Caisse d'Epargne de Madagascar entered into a partnership with USAID to promote the development of Madagascar through the financing of private sector initiatives. USAID provided technical assistance, funded staff development and purchased equipment to help in the privatization effort. The aim was to build a stronger financial institution that would one day become a private bank. Previously authorized just to help people save money, the CEM could now lend money, spurring business development, private investment and ultimately economic growth in Madagascar, one of the poorest countries in the world. Both the CEM and USAID were particularly interested in providing financial services to the middle class and the poor, who previously found business and personal loans unavailable.

The Caisse had made remarkable improvements over the last few years, encouraging its management and staff, and impressing and pleasing their American collaborators. But Paul André was determined not to rest on his laurels. "We will not become a bank right away," he said, "but personnel will be trained so there won't be any holes in our transformation from an autonomous financial institution to a bank. The CEM can be the biggest bank in Madagascar. It is the only financial institution with a presence in all the corners of the island. Even without waiting to be a full-fledged bank, the CEM can contribute to national development. We are going to help small and medium-size businesses create jobs and increase production. CEM isn't going to develop this country on its own, but we'll do our part. The best future the Malagasy can hope for can come from the CEM."

Much remained to be done to achieve this goal, requiring the continued efforts of the entire staff. Paul André asked his managers to come to a meeting that morning prepared to discuss what the CEM needed to address. There were so many operational changes underway, so many new products and marketing efforts being launched, and so many financial issues demanding attention, that concerted internal coordination was critical. The 45 people at headquarters were extremely busy introducing change at a pace and scale rarely seen in the island's history.

As he waited for the others to arrive, the general director made some mental notes to himself, listing his major concerns about the CEM's legal status, financial stability and customer service. He knew that he and his

key managers needed to develop an action plan for the next several weeks.

History of Madagascar

Madagascar is the fourth largest island in the world, located off the southeastern coast of Africa (Exhibit 1). Its population is largely tribal in nature, with the Merina tribe representing 99% of the people.[3] The presence of Arab, Indonesian and English traders and missionaries influenced the country's history, culture and economic development over the 17th and 18th centuries. Madagascar was then colonized by the French in the late 19th century.

In 1960, Madagascar gained its independence. This created the First Republic, which elected its first president, Philibert Tsiranana. Tsiranana pursued a form of democratic capitalism and was receptive to foreigners. Former French colonizers remained, and some maintained that Madagascar had simply made a transition to quasi-colonization.

Exhibit 1

MAP OF MADAGASCAR

Malagasy (the people of Madagascar) sentiment began to turn against the French, around 1972 and nationalism grew. Foreign businesses were threatened. Some were nationalized and others were forced to leave.

The country was already struggling when the Second Republic began in 1975, but the economic situation deteriorated even further under the second president, Didier Ratsiraka. Ratsiraka's administration began a nationalistic campaign that shifted the economy from capitalist to socialist. Foreign investment left and the business climate deteriorated.

In the late 1980s the Second Republic began to allow more free market activities but continued to suppress democratic initiatives. Opposition and frustration grew, and in 1991 there were general strikes that lasted seven months. In August 1991 a peaceful march of hundreds of thousands of demonstrators was halted by soldiers who fired into the crowd and dropped hand grenades from helicopters. The demonstrators fled in terror and the actual number of wounded and killed was never known. Shortly thereafter an interim government was put in place, and when Ratsiraka finally consented to elections in February 1992, he was defeated.

Dr. Albert Zafy became president of the Third Republic. Over a hundred political parties were formed, and freedom of speech was tolerated. The business climate turned cautiously optimistic and a few Malagasy returned from overseas to open businesses.

That optimism began to erode about a year later as the government proved incapable of imposing serious economic reforms. Donor funds were desperately needed to help with debt payments and to fund development projects. However, ongoing talks with the World Bank and the International Monetary Fund stumbled along as Zafy (the president of the National Assembly), Francisque Ravony (the prime minister) and Pastor Andriamanjato (CEM's president) disagreed over how to finance the country's debt.

The debate centered around two issues: (1) what requirements to accept in return for IMF and World Bank funding, and (2) whether or not to continue parallel financing. In return for a loan, the IMF and the World Bank made specific macroeconomic demands of the government of Madagascar. These included the typical requirements that government reduce its deficit spending and allow its currency to float. Stipulations were placed on the level of price support provided for rice, and the targeted level of economic growth and progress in privatizing government-owned industries. The results were quite jarring for the country's businesses. Within a period of a few months in 1994, everyone's savings dropped 50% in value. During the political upheaval of the past few years, negotiations with the World Bank and IMF continued sporadically. Discussion focused on macroeconomic concessions and, more recently, on the government's practice of parallel financing.

Parallel financing referred to the practice of accepting loans from other governments or private businesses beyond the financing already received from the World Bank and the IMF. Entering into loan obligations with another country or business increased the risk that the government might miss a debt payment to the IMF or World Bank. Furthermore, loans negotiated under parallel financing frequently required a letter of credit, or some type of preliminary payment or business concession from the government before the loan would be granted. In one situation a European entity was given rights to mine some Madagascar natural resources under the expectation that it would offer the country a loan, even though that loan never materialized.

The IMF and World Bank objected to parallel financing because it undermined their attempts to steer the economy. The intention of parallel financing became murky as companies that promised loans were granted benefits even though their promised loans never came through. Ravony, the prime minister, began to turn against the idea and antagonism grew between him and Zafy, the legislative president. Each side accused the other of promoting policies that demonstrated their selfishness and unwillingness to pursue the country's best interest. Meanwhile, unfortunately, focus on other important political, social and economic problems waned. Everyone believed the government was corrupt, and the denials of wrong-doing often heard from politicians were viewed skeptically as mere face-saving.

Participants in a monthly business roundtable expressed their increasing frustration with the government's inability to work together for economic progress. One exclaimed with exasperation, "We don't want to have anything to do with the government. People assume anyone connected with the government is corrupt, and we don't want that reputation. How can you change them? I prefer just to tend to my business."

Madagascar's Economy

In 1991 Madagascar's per capita GNP was US$210. In the same year Madagascar was listed as the tenth poorest country in the world. Exhibit 2 shows comparative economic indicators. Some causes of this poverty were complicated historical and political factors such as colonization, corruption, nepotism, socialism and limited political participation.

There was a great need for solid business development to bring life to Madagascar's feeble economy. The country's population and economy were largely agrarian. About 80% of the country's 13.8 million people lived in rural areas, and a large percentage of the population was engaged in subsistence farming.

With a large informal sector and a growing barter economy, it was difficult to obtain meaningful indicators of economic strength. Estimates were that less than four percent of the active work force was paid wages. Unemployment in 1994 was estimated at 40% while inflation wavered around 35%.

There were five banks in the country that offered a full range of services. Two were government owned, but they were having financial difficulties due to a long history of bad loans. Two served upper-middle-class customers, and they were either foreign owned (Credit Lyonnais) or a joint venture (BMOI). The fifth bank served wealthy NGOs.

Exhibit 2

ECONOMIC INDICATORS OF SELECTED COUNTRIES

Selected Economies	GNP Per Capita (US Dollars 1991)	Average Annual Growth Rate
Mozambique	80	-1.1
Ethiopia	120	-1.6
Madagascar	**210**	**-2.5**
Bangladesh	220	1.9
Kenya	340	.3
Honduras	580	-0.5
Morocco	1,030	1.6
Thailand	1,570	5.9
Spain	12,450	2.8
Italy	18,520	2.2
United States	22,240	1.7

Source: World Development Report 1993 (Washington, DC: The International Bank for Reconstruction and Development, 1993).

History and Organization of the Caisse d'Epargne

The Caisse was established in 1919, when Madagascar was a French colony, as the local branch of the French Caisse d'Epargne. Although not stated explicitly in its decree, the purpose of the CEM was to serve as a financial savings institution available to all. The CEM achieved these objectives by offering a low minimum account balance and creating a wide network of offices by functioning as a unit of the post office.

When Madagascar gained its independence in 1960, ownership was transferred to the government of Madagascar but the CEM continued functioning as before. The CEM maintained its deposits with the Caisse d'Epargne in France until 1975 when they were finally repatriated and placed in Madagascar's Treasury.

The CEM differed from other Malagasy financial institutions in three ways: (1) it did not offer loans, (2) it had an extensive network of branch offices throughout the country, and (3) the majority of its customers were poor. The CEM was not a bank, but rather a savings institution. Like a bank, it took in deposits, but unlike a bank, it made no loans. Instead, its deposits were kept with the Treasury, which set the rate the CEM earned on these funds. In order to honor customer withdrawals and cover its operating budget, the CEM withdrew funds from the Treasury. The CEM retained legal claim to its deposits held by the Treasury, but the Treasury could make temporary use of them to pay for government activities.

The Caisse operated through a network of 461 post office outlets distributed throughout the country, serving approximately 290,000 depositors. In contrast, the branches of the five commercial banks were located only in the major cities. The CEM's minimum deposit, 100 Fmg,[4] made it possible for everyone to open an account. In this way, the CEM encouraged savings among the poor.

Throughout its history, the CEM had always been government-owned, though the Malagasy system allowed for several levels of government ownership. In recent years the CEM gained increased independence by being reclassified legally (described below). As the CEM became less strictly controlled by government, its managers gained more power to take initiative, make decisions and negotiate flexible uses of customer deposits.

From independence until 1985, the Caisse was administered as part of the Post, Telephone and Telegraph (PTT). It was required to keep its deposits with the Federal Treasury, and its 20-member board of directors were all government appointees.

In 1985 the CEM became a "public establishment of industrial and commercial character" (an "EPIC"). The EPIC status gave it more administrative autonomy by changing its administrative structure but not its physical network. No longer an agency of the PTT, its senior management had more leeway to make independent administrative and organizational decisions (such as restructuring the organization, or remodeling the head office). Even though the CEM management officially reported to a Board of Directors, that Board had met only three times in five years. Structurally, the Caisse continued to have its teller windows in post offices around the country and postal employees performed the CEM procedures. These tellers and their supervisors, the postmaster generals, were employed and paid by the PTT.

Portrait of Paul André Andriamamonjisoa

Mr. Paul André, the general director of the CEM, was a charismatic, intelligent and hardworking man who firmly controlled job prospects of the people who worked for him. He was a product of the PTT educational system, having received his college-level training from the PTT in Madagascar and postgraduate education from the French equivalent in Paris. He was appointed by the minister of finance, though no active board of directors oversaw his deeds. In personal style, he was decisive and temperamental. He usually made good decisions, but sometimes treated people poorly because of his quick temper. He might lash out angrily with, "Why was this mistake made?" and insist there be changes, though he may have little idea what needed changing. He held power firmly, took his responsibilities seriously and managed paternalistically. When his daughter died in the midst of the developments described in this case, he was back at work three days later.

Advent and Challenges of Privatization

Paul André had a strong sense of the potential role the organization could play once allowed to operate as a private sector player. Privatization could benefit CEM customers and aid in the economic development of the country. If it became a private institution, the CEM would be free to decide where it placed its deposits (the Treasury paid close to 12% interest) and set the interest it paid its customers. Loans from traditional banks, in contrast, were severely limited and demanded a very high interest rate (typically 18%, sometimes as high as 35%). The CEM could thus begin lending at a lower rate than competitors but still earn more than what the Treasury paid on CEM deposits. With access to capital, CEM customers could build homes, pay school fees or start businesses, all of which would benefit their families and contribute to Madagascar's economy.

The Caisse was working aggressively to become a private financial institution. Late in 1994, the CEM submitted a statute to the government which, once approved, would restructure the Caisse as a Société Anonyme (SA), an autonomous entity or a limited liability corporation. SAs could be either government-owned or privately held. The statute awaited a vote by the National Assembly.

As a Société Anonyme, the CEM would have increased administrative and financial independence. Most significantly, it would be able to make loans and attract private capital. Once 51% of CEM stock was privately held, the Caisse would be an independent, private financial institution, able to name its own board of directors and manage its finances without any government directives.

Neither the CEM physical structure nor its method of operation had significantly changed over 45 years. Tellers were barely visible behind papered, smeared windows. All customer transactions were recorded by hand, and paperwork was delivered to the back office where it was eventually entered into a computer. Every other bank in Madagascar offered several types of savings accounts, open teller windows and computerized account transactions. Thus the CEM had to make major improvements in its facilities and services in order to become competitive.

Optimistic that the CEM would soon become a Société Anonyme, the Caisse management did not wait to undertake significant change. Between September 1994 and June 1995, the CEM redesigned teller

windows, rewrote computer software, revised its accounting system, started installation of new computers and trained employees in subjects such as human resources, communication and accounting. These initiatives helped provide the organizational and physical structure as well as the human capital necessary to position the CEM as a viable financial institution prepared to make the transition to a private bank.

Attaining Financial Stability

It was essential that the Caisse improve its financial position before it could begin lending or seeking private capital. Due to an error in the Treasury's method of accruing interest, the CEM actually operated at a loss for years before 1994. From 1972 to 1985, the Treasury did not pay interest on some of the CEM's deposits, while the CEM continued to credit interest to depositors' accounts. The problem was discovered in 1985, and the Treasury began paying a preferential interest rate to make up for years of back-owed interest. When USAID began collaborating with the CEM eight years later, it helped negotiate final payment for the total amount of interest owed as of 1985.

Until 1994, the interest rate that the Treasury paid on CEM deposits was not indexed. In 1994, the Treasury agreed to link the rate to the Treasury Bill, and the 1994 annual average was 15.23%. There was an understanding but no legal guarantee that the Caisse would receive a minimum of 11.5% return. Standard CEM customer deposits earned 6.65%, and a premium rate of 8.45% was paid on accounts with annual deposits of 50,000 Fmg and no more than four withdrawals.

With the lump sum interest payment from the Treasury and the new higher interest rate, the CEM was in a much better position financially. It was finally able to show the profit it had earned. (No Balance Sheet or Income Statement were readily available from the institution. These financial statements had not been prepared for several years.)

To become stronger and grow financially, the CEM needed to increase deposits. The Caisse management team had set aggressive goals for increasing the amount of deposits and the number of depositors and now needed a way to achieve these objectives. Deposit growth goals appear in Exhibit 3. Clearly the CEM needed to offer customers more than a mere passbook savings account to achieve these numbers.

Senior management began by focusing on new saving vehicles, or liability products, so named because a liability was incurred when the CEM took in a deposit. Loans, on the other hand, were asset products because by granting a loan the institution acquired an asset—the principal borrowed and interest owed. The managers devised a strategic marketing plan outlining six new liability products that would be launched from 1995 to late 1996, and they described several asset products that would be offered in 1996 or 1997 (see Exhibit 4). Paul André and his colleagues spoke of eventually lending to small businesses, but they knew this type of lending was very difficult to do profitably and that it would happen only after they had been successful with less risky lending, such as school fees or mortgage loans.

Exhibit 3
THE CAISSE D'EPARGNE FINANCIAL OBJECTIVES

Deposit Growth
(in Millions Fmg)

Year	*Level of Savings*
1996	38,000
1997	52,000
1998	78,000
1999	108,000
2000	138,000
2001	178,000

Building Public Image

The CEM undertook marketing efforts for the first time when it celebrated its 75th anniversary in 1993. It broadcast radio commercials in rural areas and held a festive event with a computer on-site to calculate expected interest earnings for depositors. Given the

Exhibit 4
THE CAISSE D'EPARGNE'S PROPOSED NEW PRODUCTS

Liability Products	
A- Existing	Passbook Savings
B- First Phase 1995-1996	Retirement Account School Savings Certificate of Deposit
C- Second Phase 1997	Mortgage Savings Plan
Asset Products	
C- Second Phase 1997	Loans against Passbook Savings Loans to larger corporations Loans for education Loans to small businesses

favorable response to this brief campaign, CEM management believed they could grow deposits significantly with a structured approach to marketing, but they did not have the resources or experience to devote to it. In the fall of 1994, USAID hired a consultant to work with the CEM for ten months. Paul André asked her to serve as the acting director of marketing.

In early 1995, the consultant along with two recently hired marketing assistants began a series of focus group interviews with targeted middle-class and foreign potential customers to discuss their perceptions of the Caisse and their reactions to potential new products. People expressed high name recognition for the Caisse but limited understanding of its functions, and because they associated it with the post office, respondents had a negative image of it. Those who had visited the Caisse, even if it had been years ago, remembered it as being dimly lit and dirty.

With this feedback, the marketing department determined that the CEM needed to improve its image if it were to attract new deposits. The CEM had to persuade people that it was a solvent institution which offered a friendly, efficient and pleasant atmosphere. Mere rhetoric would not suffice to change perceptions. Given their history and politics, Malagasy were skeptical of promises. The CEM had to live up to any claims of change and improvement. The marketing department recommended expanding and improving services. Expansion could be achieved by creating more full-service branch offices (those that can open accounts, take deposits and pay withdrawals, rather than just take deposits). Improved service would be accomplished by modernizing the head office teller windows and accelerating account transaction time in what was still a largely manual operation.

The marketing department knew the CEM could not try to launch new products before it had educated the public about the nature of CEM and improved its image. Once the improvement in service had been implemented, a two phase marketing campaign would begin. First would be the inauguration of the remodeled CEM. Press coverage would explain the role of the CEM and the changes it had accomplished as well as those underway. The second phase was to begin in June 1995, with the advertisement for the CEM's newest savings product, the Bon d'Epargne, or the Caisse Savings Bond.

Expanding Services

Although the CEM boasted 461 outlets, in reality only 46 were full-service sections (capable of opening accounts, taking deposits and paying withdrawals). Organizationally, the CEM consisted of (a) the head office, (b) section offices, (c) local account offices, and (d) basic deposit-taking offices. The head office handled the Caisse business exclusively. Of the CEM's 290,000 customers, about 70% were in the capital city Anatananarivo (nicknamed "Tana"). All other outlets were just a teller window in post offices. Usually the teller handled postal responsibilities as well. Accounts could only be opened in the 46 section offices where deposits and withdrawals could be made as well. The 113 local account offices could accept deposits but withdrawals were only possible if an authorization form had been completed and account information transferred from the head office. Services at the remaining 302 offices were even more limited.

The marketing plan called for an upgrade of a few local account offices to full-service branches throughout the year. Paul André wanted these transformations to coincide with the CEM's scheduled financial reporting in mid-June and year end.

Improving Customer Service

Remodeling the head office had already begun before the consultant made the recommendation to improve services. Paul André and René Randrianasolo, the teller manager, agreed that revising teller procedures would be beneficial. They decided to change teller processes in conjunction with the redesign of the facility. The two modifications would be timed so that revised teller procedures would go into effect when the new teller windows opened.

It was not uncommon in the past to see up to 60 customers waiting in the lobby at the CEM's main office. People shared precious bench space, while others leaned against walls or simply stood by patiently. Opening an account could take an hour. Teller "windows" consisted of 3' by 4' enclosed booths with the glass papered over so customers could not see the tellers hunched over the counter they shared, a bald light bulb illuminating their work. A door at the back of the booth led to an office that was also poorly lit, dirty and cramped.

The new procedures would go into effect on January 16, when the remodeled teller windows were to open. The entire teller department participated in revising the account transaction execution process. Tellers and bookkeepers discussed every step in opening an account, accepting a deposit and honoring a withdrawal. They examined the reason behind each step in the procedures—with the intention of establishing more efficient methods without sacrificing security.

An all-staff meeting was held January 14 so that Paul André could verify the changed procedures and hear feedback from tellers. Afterwards the tellers headed back to the office to practice the new processes. When

they arrived at the CEM, the rehab work was still underway. Bits of brick flew as a worker wielded a hammer, knocking out part of a wall. Pounding and hammering reverberated throughout the building and dust was everywhere. Two sales agents shook their heads and muttered, "It'll never be done by tomorrow." Over the past few months, Paul André had remarked several times, "Night and day. Weekends and holidays. These workers are working all out." But now, on the eve of the opening, it seemed unlikely that the deadline would be met. Paul André scowled and growled at a worker, "Where is the supervisor?" The supervisor and Paul André stepped outside for discussion. When they returned, Paul André told the tellers to return on Sunday to practice the procedures.

On Sunday when the teller staff returned, the work had progressed significantly but was not yet finished. Tellers received uniforms and everyone put them on and admired themselves and each other. The construction work continued around them as they practiced the new procedures for account transactions.

Monday morning almost everyone was early for work. Somehow the work had been sufficiently completed overnight to make the new teller windows functional. The tellers were excited and a little nervous as the first customers arrived.

Customers were immediately surprised by what they saw. Smiling workers greeted them from behind clean glass dividers at four-foot-wide marble teller counters. Customers were served quickly and some paused as they left to tell Paul André and others how pleased they were with the new CEM.

Once customer service had been improved, the CEM began its media campaign. People responded very favorably to the CEM publicity. Account openings increased 68% in May, averaging 90 new accounts a day. Crowds grew at the head office and, by June, the CEM lobby began to look as crowded as it had before January, with dozens of people waiting to be served-now, with the old benches removed, however.

The teller department complained about the crowds but did not have the resources or the freedom to hire new staff. A marketing assistant was assigned to work at the teller window to get a sense of the bottleneck, but he never had time to address the problem.

Installing Computers

Over the next few months, the old teller space was gutted and converted into a computer lab. USAID purchased 15 computers for the CEM, with which it would begin to automate its services and build a network to link its major offices.

The lack of computerization was partly to blame for the limited services at branch offices. The head office received documentation of every account opening and transaction, but it was the only office with a working computer system. Data was entered into the system only after a series of administrative controls, and work was sometimes backlogged for more than a month. With over 290,000 customers, duplicate records could not be transmitted to other offices, so customers could only be serviced at the office where they opened their account. A computerized network, therefore, was expected to have a profound impact on the CEM since account balances could be easily obtained at linked offices. This would enable the Caisse to take further advantage of its network, forming the largest financial institution in the country. The 15 computers were to be distributed to the largest section offices and local account offices in and around Tana.

Before computers were distributed, however, customer records had to be improved. All transactions were normally written down on large sheets of construction paper and filed away. Most transactions were also recorded in the computer, but substantial differences remained between these two records, requiring a major effort to update computer records. A team of temporary data-entry clerks were hired for this work. Management estimated that if the CEM assigned them to work in three eight-hour shifts (24-hour days) for five days a week, it would take about three months to complete the backlog and fully update the computer records.

Bernard Raholiarisoa had worked for several years overseeing the computer system. When the organizational chart was discussed, Paul André decided Bernard would become director of management information systems (MIS). Shortly before the new computers were delivered, Bernard met with USAID's MIS director, Roland Rakotomanana, to discuss the implementation of the local area network (LAN). After the meeting, Roland confided that Bernard "has a lot of software knowledge, but very limited understanding of networks." Roland met with Paul André privately to express his concerns, but before he could explain the problem, an interruption turned the discussion in another direction.

Employee Morale

The tellers who worked at the CEM Head Office were still technically postal employees. Once the CEM became a SA, the tellers would be allowed to choose whether or not to become CEM employees. Tellers at other branches would remain postal employees, with the CEM paying the PTT for their service.

Several days after the new windows were opened, René, the teller manager worried out loud about his

employees, "They used to eat at their desks, but they can't anymore because of the open teller windows. They are embarrassed to eat in the conference room because they don't want others to see how little they eat; they eat just enough to not be hungry. The CEM employees get a lunch allowance and Paul André said a while ago that if we do a good job, we might get it, too."

A few days later, Paul André informed the tellers that they would get a lunch allowance of 1,500 Fmg, and they were very appreciative.

Nonetheless, other frustrations surfaced. Walking home from work, one teller commented, "We are working like dogs. We aren't paid any more than before, though. We have to decide soon whether or not we will become employees of the CEM or return to the postal system. We make the same amount of money as postal clerks, but we are working so much harder. The CEM employees in the accounting department have better benefits. No one tells us what is going to happen. We don't know what benefits we may get. Why should we work this hard when we could be clerks in the post office?"

When asked if the tellers would soon be incorporated into the CEM staff and if they would receive the same benefits, Paul André remained paternalistic towards his back office people and, still regarding tellers as somewhat tainted by their postal background, replied, "You see, they aren't CEM employees yet. I've told René to get me the statute that explains the organization so that I can alter it to incorporate tellers into the CEM. But the accountants, the current CEM staff, they will always have different benefits."

Planning Next Steps

Paul André asked the USAID consultant to write a report describing her work and her recommendations for the CEM. He thought her observations would be interesting since she worked so closely with senior management for ten months. Paul André distributed her report to his colleagues in preparation for the meeting since it outlined a wide range of issues warranting their attention. Exhibit 5 is its Executive Summary. He then asked that they consider it in recommending next steps in the CEM's transformation.

Paul André thought about the issues to address at the morning's meeting. He knew he wanted to discuss the progress of the statute, the growth in deposits and the plan for installing computers. But he also wanted to

Exhibit 5

CONSULTANT'S REPORT TO THE CAISSE D'EPARGNE EXECUTIVE SUMMARY

The consultant was asked to design a marketing plan and implement the first phase of its campaign. She worked with CEM personnel to improve customer service and to launch the Bon d'Epargne (certificate of deposit), a new savings product. In the course of this work, she observed CEM operations which led to the following recommendations for improving customer service and marketing efforts of the Caisse:

1. Increase the number of teller windows and/or personnel to accelerate customer service time.
2. Increase the number of offices opening accounts by transforming Local Account offices to full-service branches.
3. Continue to conduct focus-group interviews as a part of product development.
4. Continue to use a team for product development, making sure to include a lawyer.
5. Recalculate product profitability to improve its accuracy.
6. Continue to use a team to write and revise product circulars.
7. Make branch managers more accountable for training their tellers about the new product procedures.
8. Review current relationship with vendors and agree on standards for service before assigning future work.
9. Incorporate services to and for youth in the marketing campaign for the Student Account.
10. Interview businesses for suggestions for product development for the Retirement Account.
11. Target the rural network for service improvements and marketing campaigns.

In addition to these marketing suggestions, the consultant has three general recommendations based on her interactions with other branches of the Caisse:

1. Improve communication at all levels.
2. Implement computerization with great attention.
3. Revise work procedures and set employee performance objectives.

hear his managers' comments about progress to date, and their views of the future of the Caisse d'Epargne.

NOTES

1. The case was prepared by Eileen McKeough under the supervision of Professor James A. Phills as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

2. Malagasy typically address one another using first names. In a situation where respect for position or hierarchy is appropriate, an individual is addressed by prefacing the first name with a title, or Mr. or Mrs. Hence, Paul André Andriamamonjisoa was referred to by the CEM staff as Mr. Director General, or Mr. Paul André.

3. Centuries ago the country was unified by a group of people who became royalty. That background is revealed today through the prefix Andria in a person's last name, such as with Paul André Andriamamonjisoa.

4. The Malagasy currency is the Franc Malagache, Fmg. In April 1995, the exchange rate was approximately 1 USD = 4,000 Fmg.

Frank Davis Comes To Madagascar[1]

Anatananarivo, Madagascar

Frank Davis entered the cocktail lounge at the Madagascar Hilton Hotel, located in the nation's capital city of Antananarivo, and quickly scanned the room. Behind a cloud of cigarette smoke in the corner there was a table of boisterous French businessmen. A few other tables of two or three people were scattered throughout the lounge. Frank chose a seat at the bar next to a well-dressed white man who looked like he might be American. This was Frank's first visit to Madagascar and he wanted to get the impressions of other Americans doing business there.

"What would you like?" asked the bartender in slightly accented English.

"A beer, please. What kind do you have?" Frank asked.

"Actually the THB isn't bad. It's the local beer," offered the well-dressed gentlemen next to Frank.

"Thanks. I'll try a THB," Frank told the bartender.

"Is this your first time in Madagascar?" asked the man after introducing himself as Jean-Paul, an American of French descent.

"Yes. I'm here evaluating the local business climate. I work for a U.S. food processing company, Summit Foods, that is interested in the local spice market. How about you?"

"I head up the operations of a textile company in Madagascar's free trade zone, Zone Franche. I've been here since right after the presidential election in 1993."

Frank was somewhat familiar with the recent political history based on background material he had received from the U.S. State Department. Madagascar was a former French colony that had gained independence in 1960. Since independence, there have been four presidents: Tsiranana, from 1960-1972, and Ratsimandrava, assassinated in 1975, were both in power during the First Republic. Then came Ratsiraka, who introduced the country to the Second Republic and socialism, but he was forced to yield to a transitional government in 1991 after a six-month strike. In February 1993 the current president, Zafy, was elected after a popular referendum which adopted a new constitution establishing a mixed presidential-parliamentary regime. Since the late 1980s and particularly under Zafy's Third Republic, the country was attempting to shift to a free-market economy from a centrally planned one.

"A textile company?" said Frank. "Then you must be pretty familiar with the general investment climate here. My boss is convinced there's a lot happening in this country because he has a distant relative who made a fortune here. But I haven't had a chance to look around yet, except for the ride from the airport to the hotel, and that was pretty depressing. The poverty seems to be so pervasive, and yet we passed several Mercedes and sport utility vehicles that didn't seem to be driven by foreigners. I don't get it."

Jean-Paul laughed and shrugged his shoulders. Although he was smiling, his eyes seemed to be sad. "Investment climate? Investment climate . . . Well, I guess it depends on how you define it, and how badly you want to invest. It also depends on who you know and who you are willing to pay to get things done."

Frank's eyebrows shot up. "Pay to 'get things done'? Like what things?" he thought to himself. He let Jean-Paul continue.

"The Third Republic is about two years old. The present administration was elected after a general strike that brought the government and the economy to a standstill. Conditions were bad, wages were low and people got sick of socialism because it seemed to be benefiting only those in power, not the country. The new administration claims to support free-market capitalism, but according to many of my Malagasy business associates, this crew is almost as bad as the crew they voted out."

"But your company is still here. Obviously you are making money if you're still here, right?"

"Believe it or not, we're making money despite the local business climate and the Malagasy government, not because of it. Thanks to the Zone Franche, we pay no taxes on our export receipts and we can hold our profits in U.S. or French currency. Otherwise all the foreign exchange we earn would have to be directly deposited into local banks and then would be automatically converted and held in Malagasy currency. If we were not in the Zone Franche, each time we needed foreign exchange to do business outside the country, we would have to apply for it and, of course, pay a fee! Our firm is doing okay here due to the low barriers to entry in the textile industry, low labor costs and the ability of the Malagasy work force to master new skills quickly. But you would not believe all we've gone through to get where we are now." Jean-Paul fell silent and took a long drink of his beer.

Frank was thoughtful. "This guy doesn't seem too optimistic, but he himself said he's making money. I wonder what kinds of problems he ran into."

"Don't get me wrong. This is a beautiful country and the people work incredibly hard. When I first came here after President Zafy took office, I was full of optimism and could see lots of possibilities. I've been in operations management for 20 years. I've dealt with unions, weathered the effects of the energy crisis and foreign

Exhibit 1

SPICES OF MADAGASCAR

SPICES CURRENTLY EXPORTED

English Name	French Name	Malagasy Name	Latin Name
Cinnamon	Cannelle	Kanela	Cinnamonum zeylanicum
Tumeric	Curcuma	Tamotamo	Cucuma longa
Ginger	Gingembre	SakamalaJirofoo	Zinngiber Oofficinale Roscoe
Clove	Girofle	Jirofo	
Hot or Chili pepper	Piment capsicum	Sakay	Capsicum frutescens
Black peppercorn	Poivre noir	Kipoavatra mainty	Piper nigrum
Green peppercorn	Poivre vert	Dioavatra maitso	Piper nigrum
Vanilla	Vanille	Lavanila	Vanilla fragrans

Source: May 1994 Study of Madagascar Exports for Horticultural Products, ATW Consultants for USAID

SPICES WITH EXPORT POTENTIAL

English Name	French Name	Malagasy Name	Latin Name
Pink Peppercorn	Baie rose	Voatsiperifery	Schirus terebenthifolius
Mace	Macis		Myristica fragrans
Nutmeg	Noix de muscade		Myristica fragrans

Source: May 1994 Study of Madagascar Exports for Horticultural Products, ATW Consultants for USAID

competition on the textile industry, as well as the relocation of our company to the southeastern United States from Massachusetts, my home state. I've even helped my company locate a facility in Taiwan. But it hasn't prepared me for some of the things I've dealt with here." He smiled ruefully and pushed back his chair. "Oh, and one more thing," Jean-Paul added.

"What's that?" Frank asked, eager for more information

"Do you have an umbrella?"

"An umbrella? No. Why?" Frank asked, puzzled by the amused expression on Jean-Paul's face.

"Buy one, you'll need it. We're getting into the rainy season here, complete with cyclones. You'll see what I mean soon enough. I wish you luck."

"Cyclones!" Frank thought to himself. "Thanks," he said to Jean-Paul's back as he headed towards the door. Frank wasn't sure whether Jean-Paul was wishing him luck with his assignment or in weathering the rainy season in Madagascar. He felt a bit discouraged, but at the same time his interest was piqued. He smelled a challenge and envisioned himself as an investment pioneer in rugged territory.

Frank's Assignment

Frank Davis had been sent to Madagascar on an exploratory mission by his supervisor, Martin Herlihy, a regional vice president of a multinational food processing company, Summit Foods, based in the United States. Frank had been asked to identify potential opportunities for the company to either import agricultural products or set up a food processing operation in Madagascar. He was also asked to assess the country's general investment climate. Even if opportunities could be found, Frank's boss knew there could be several non-

Exhibit 2

EXPORTS OF NON-TRADITIONAL SPICES FROM MADAGASCAR

1993

Customs Code	Spices	Quantity in kg	Value FOB (1000 FMG)*	Price/kg OB (1000 FMG)*
090411100	Green peppercorns in brine	371,559	1,616,136	4,350
090411900	Other peppercorns, not ground	1,470,148	2,506,289	1,705
090412000	Peppercorns, ground or crushed	4,824	37,064	7,683
090420000	Chili peppers, dried or ground	20,022	96,635	4,826
090610000	Cinnamon, whole	1,169,319	1,704,081	1,457
090620000	Cinnamon, ground or crushed	46,724	86,310	1,847
090810000	Nutmeg	143	1,725	12,063
090930000	Cumin seeds	150	99	660
090950000	Fennel seeds	245	36	147
091010000	Ginger	17,461	8,682	497
091020000	Saffron	146	194	1,329
091030000	Tumeric	2,256	15,402	6,827
091040000	Thyme	48	81	1,688
091050000	Curry	232	1,518	6,543
0910099000	Other spices	476	6,619	13,905
	TOTAL	**3,103,753**	**6,080,871**	

Source: State Data Bank (BDE) Antananarivo

*Average rate of exchange in 1993: 1 US$ = 1,900 FMG
1 FF = 330 FMG

quantifiable costs of doing business in a developing country that could render an otherwise profitable project infeasible. Frank's foresight and good judgment had saved the company money in past expansion projects, and Martin knew Frank would be thorough in considering the many factors that could influence a potential investment. Martin was eagerly awaiting Frank's assessment of the situation.

Martin Herlihy was interested in expanding Summit Foods' product offerings to include spices. Due to the heightened health consciousness of U.S. and European consumers, spices were quickly replacing oils and heavy sauces as a natural flavor enhancer in both commercially processed and prepared-at-home foods. Given the increased numbers of dual-income families, consumers cooked at home less often than they did twenty years ago. However, they were using more volume and a greater variety of spices when they did cook at home. Ethnic cooking and ethnic restaurants were extremely popular, and that preparation required many nontraditional spices.

Madagascar was known for its spices, particularly vanilla and cloves. Martin asked Frank to find out about other types of spices grown in Madagascar and their current production levels. He felt strongly that the Malagasy government would encourage export of spices because he knew that cloves and vanilla were historically the main sources of foreign currency earnings in the country.

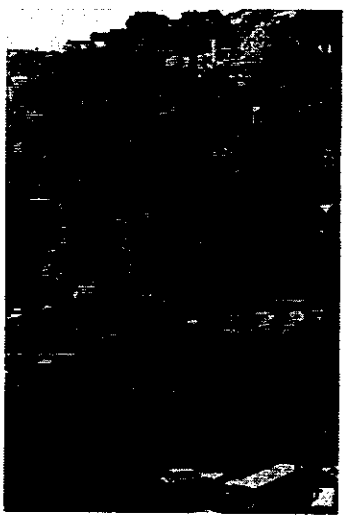
The restaurant at the Hilton did not serve dinner for another hour and a half. Frank decided to take a walk around the neighborhood of the hotel. Although he had researched Madagascar as thoroughly as possible before he left the States, he had not found much information beyond the official reports put out by government agencies such as the State Department and the Commerce Department. He had learned that Madagascar was the world's fourth largest island with a population of 12.5 million, 1 million of whom lived in the capital, Antananarivo, where he was staying. The annual population growth rate was estimated to be 3.19%, with a fertility rate of 6.68 children per woman. In economic terms, this could mean a largely untapped consumer market if the people had disposable income to spend. But Frank was not sure how to assess that yet. The annual per capita income was about $230 but he did not know what the median income was, or what the cost of living was.

He knew Madagascar was approximately the size of Texas and rich in natural resources such as graphite, chromite, coal, bauxite, titanium, salt, quartz and tar sands, as well as semiprecious stones. His environmentally-conscious friends in the States knew that the country was home to many species and even genuses of flora and fauna that were indigenous nowhere else in the world. He also knew that there was widespread soil erosion caused by deforestation and overgrazing, and that this was contributing to desertification of the island. Several species of plant and animal life were endangered.

Frank also knew a little about the Malagasy people. Their ethnic origin was a combination of Malay-Indonesian, African, Arab, French, Indian and Creole. The religious composition of the population was 7% Muslim, 41% Christian and 52% indigenous beliefs. A strong emphasis on ancestor veneration characterized most spiritual belief in the country. Over 90% of the Malagasy work force was employed in the agricultural sector, including fishing and forestry, and the major exports included coffee, vanilla, cloves, shellfish, sugar and petroleum products. The chief industries were largely agricultural product processing (such as meat canneries, soap factories, breweries, tanneries and

Exhibit 3

SCENES OF MADAGASCAR



Buildings fill the hillsides around downtown Antananarivo

A street vendor displays local produce in the market

sugar refining plants) and textile factories, like the company Jean-Paul represented.

The first thing that struck Frank after leaving the grounds of the Hilton Hotel was the poor condition of the infrastructure—streets, sidewalks, and the storm drainage or sewer system (he was not quite sure what the purpose was of the little streams that ran alongside the streets)—and the absence of traffic signals. Come to think of it, he did not remember stopping at a single red light on the way from the airport. An extensive and well-maintained transportation network certainly would contribute to the success of any agriculturally-based economy where the producers were geographically dispersed throughout the country.

Frank also recalled that the Madagascar airport was served almost exclusively by Air Madagascar, a state-owned enterprise. The lack of competition would likely keep the cost of freight and passenger travel high, with little incentive to improve service efficiency. Despite the poor roads and lack of traffic signals, there was certainly no shortage of cars in the capital, and almost every third car seemed to be a taxi. The air was hot and hazy, thick with car exhaust. Frank noticed several buses so full of people that the back doors remained open and two or three people clung to the outside.

As he continued down the street, Frank was approached by several people selling a variety of items which they pushed at him; handicrafts, Ray Ban sunglasses, brooms, tire irons, a basketball and some fruits or vegetables he did not recognize.

"Non, merci," he said over and over again, but they continued to walk alongside him displaying their wares.

"Bon marché! Combien, Monsieur?" They were ready to bargain but Frank had no money and no need for a tire iron in Madagascar. He began to feel annoyed and a bit overwhelmed by the entourage of vendors. He decided to turn back after another several minutes of sales pitches in French and another language which he assumed was Malagasy. It occurred to him that he needed to change his money at the hotel before dinner anyway. As he came closer to the hotel, he was approached by a barefooted little boy in dirty rags carrying a baby on his back. "That boy can't be any more than 5 years old," Frank thought, shocked by the sight. "And the baby isn't even old enough to walk. Where are the parents?"

"Monsieur, donnez-moi la monnaie? Donnez-moi la monnaie?" the boy begged, thrusting his little hand forward. His big brown eyes implored Frank to give him some spare change. His face was dirty and his nose runny. Frank was torn inside but looked away and walked quickly back to the hotel, just as the sky was turning dark and threatening rain. Frank reminded himself to buy an umbrella as his took refuge in the air-conditioned lobby from both the rain and the pitiful scene he had confronted outside. He headed for the cashier to change his money.

The Flottement

The exchange rate was just under 4000 Malagasy francs (FMG) to a dollar. Frank recalled that when he left the United States two days before, the rate was about 3600 FMGs. "Could the rate have changed that much in three days?" Frank asked himself. Then he recalled what he had read about the monetary system. In May 1994 the FMG moved from a fixed exchange rate system to a floating exchange rate. The FMG was untied from the French franc to fluctuate on its own against hard currencies, but the French franc (FF) remained the main currency of reference. This step to liberalize the Malagasy currency was referred to as the flottement, and was required by the International Monetary Fund (IMF) in fulfillment of a planned structural adjustment program. As a result of the flottement, the FMG lost about half of its value almost overnight, setting off wide-scale price increases. Because of the weak economy, Madagascar's currency was weak. It had consistently lost value relative to hard currencies since the flottement was instituted.

"Do you need to stamp this?" Frank pushed a small currency declaration form across the counter to the cashier. He had been given the form by the stewardess on his flight into Madagascar and told to declare all his currency, traveler's checks, credit card account numbers and personal checks. The paper was barely large enough to contain all the information requested, but Frank complied. He did not want to be unnecessarily detained for not following procedures when he left the country. His tour book had warned him that airport officials would ask him how much he spent in the country and whether he was taking any Malagasy money outside the country with him.

"I'm sorry sir, we don't have a stamp. Only the banks stamp the form if you change money there," the cashier informed him.

"But aren't I required by law to have a stamp? How can the hotel exchange money for me but not stamp my form? I'm not sure I understand." Frank was genuinely puzzled.

"If you want your form stamped, you must go to a bank. But the banks are closed until Monday. If you want to exchange your money here, I'll give you a receipt, but I don't have a stamp. Do you want to change it here?"

Frank hesitated. He wanted to follow the rules but he did not quite understand them, and the cashier did not really clarify it for him. He needed the money now and

the banks were closed. Was he expected to wait two days to exchange his money, or would he have to explain his predicament to the airport officials and risk being detained at the airport? He finally decided to exchange only as much money as he thought he would need for the weekend, and hope it would not be an issue later. He did not see any other option.

"For a country that is badly in need of foreign exchange, they certainly make it difficult to convert your money," he thought to himself as he left the counter.

Government Approvals

Frank entered the dining room and was seated promptly at a corner table set for one. A short time later Jean-Paul poked his head inside the restaurant and, seeing Frank, waved and approached his table.

"Mind if I join you?" he asked.

"Not at all." Frank gestured towards a chair, "Please, have a seat."

"How are you doing? I barely missed getting caught in the torrential downpour. It's coming down pretty hard out there."

Both men stared out the window at the pouring rain. The sky was dark and ominous. It was hard to believe that just 45 minutes ago the sun had been shining brightly with barely a cloud in the sky.

After giving their dinner orders to the waiter, Frank decided to broach the topic of Madagascar's investment climate again with Jean-Paul. He felt that although Jean-Paul seemed a bit cynical, there was probably a lot he could learn from his experiences. He planned to try to schedule appointments at the Ministry of Commerce, Ministry of Industry, Energy and Mining, and Ministry of Transport, Meteorology and Tourism during his one month visit. He felt that an initial discussion with Jean-Paul would help him put things into a context and develop some meaningful questions for his interviews with the various Ministers.

"So Jean-Paul, I'm interested in hearing more about your experiences in Madagascar, if you don't mind sharing them with me. Tell me about some of the obstacles or problems your company encountered when trying to set up a facility," Frank asked.

"Well, the first thing any company interested in setting up business in Madagascar needs is an agrèment, or official approval of the government. The hard part is deciding who to approach to obtain this approval, and how to present your business proposal. You need some type of approval from every ministry which has jurisdiction over any part of your business. For example, in our case, we needed the okay of seven ministries, and each ministry has a set of questions that must be answered and documents that must be filed. Some ministries asked for the same information, others asked for information which seemed irrelevant or outside their jurisdiction. One ministry lost our dossier, but didn't bother to inform us—and maybe they didn't realize themselves—until we called to inquire about the status of the approval two months after submitting everything. The amount of red tape here is mind-boggling."

"Is there some sort of checklist or description of the type of documentation required? I mean, do they want a full blown business plan? A letter from your financial institution? What do they base approval on?" Frank asked, trying to get a clearer picture of what the Malagasy government would request.

"That's just the problem. No one seems to know. It changes from ministry to ministry, day to day. To the first ministry we approached we gave every piece of documentation we thought they could possibly use. I figured that if I was forthcoming with information and demonstrated a serious willingness to do business in Madagascar, the review process would be shorter because they didn't have to keep asking for additional information. I even gave them the names and resumes of the managers we intended to bring in to manage the new facility," explained Jean-Paul.

"That seems like a reasonable approach. Did it help expedite things?" Frank asked.

"Expedite? That's not quite the word I would use. Try *mora mora*," responded Jean-Paul. "It means slowly, slowly in Malagasy—and is often used to describe the 'Malagasy way,'" he grinned. "That first ministry was the ministry that lost it all. Or at least that's what they told us after two months."

Jean-Paul went on to explain that there seemed to be a great deal of overlap between the ministries, and even conflicting information about what types of business activities are encouraged. The laws of one ministry were often superseded by proclamations, decrees and statutes of that ministry or a different one. There was also a lack of communication between ministries, and Jean-Paul got the feeling there were little rivalries and power plays among the ministries.

"Reasons for denial or disapproval are not given, so it's difficult to address their concerns and try again. I heard from a friend that he knew someone who was denied an agrèment because they wouldn't offer an interest in their project to people high up in the ministry."

"It sounds like there's a problem with administrative efficiency and consistency. But you could probably find that sort of problem in any large organization in any country, really," Frank remarked.

"That may be true. But if you want to do business in this country and save yourself a lot of time and trouble, I'd suggest you find yourself an influential partner who is highly-placed in the government."

The waiter arrived with their dinner. As he laid the plate down in front of Frank, the lights went out and music stopped. The waiter immediately lit the candle on the table as other waiters circulated around the dining room to light those at other tables.

"Bon appetit!" the waiter said to the two men, as he walked back towards the dark kitchen. Dumbstruck, Frank watched the hotel employees for a few minutes waiting to see if someone would take control of the situation and explain to the customers what was going on. Jean-Paul and many of the other diners began eating as if nothing was awry.

"If you're waiting until the lights come back on to eat your dinner, it'll probably be cold. You might as well eat. The power will come back on eventually. It goes out just about every time there's a big rain. During rainy season, that could mean at least once a day."

Frank was surprised. Frequent power outages could obviously cause problems with production schedules and delivery dates. And what about information management? Companies which were highly dependent on data must have to take special precautions to safeguard it. Frank made a mental note to find out what provisions were made for back-up power sources, if any.

"What other types of problems have you dealt with?" Frank asked.

"The property rights laws," Jean-Paul answered. "It's been the policy of our company to purchase land and do the construction ourselves, to very exacting specifications. We have built two factories in other countries in the recent past and have found the best layout and configuration for our machinery and assembly lines. So we prefer to build from scratch rather than lease. But, as you may know, foreigners cannot own land in Madagascar. This posed a problem for us, and frankly our CEO took this to be a signal of distrust by the government."

Frank was not aware of this prohibition against foreign ownership of land. Jean-Paul went on to explain that the Malagasy culture considered the land to be sacred. He had even heard a man once say that to the Malagasy, the land is like their body. It was passed down through the generations from the ancestors, and the fact that Madagascar was an island nation probably contributed to their beliefs. Jean-Paul explained that many people get around this law by using Malagasy partners, but that this arrangement can be extremely costly and risky because the foreigner is beholden to the Malagasy. If there is ever a dispute or the relationship deteriorates, the foreigner has questionable legal recourse.

Jean-Paul's company solved the problem by leasing the land under a 99-year lease and constructing a building that would revert to the property owner at the end of the lease term. The rent was paid in foreign currency because of the high inflation rate. This eliminated the need to have the rents adjusted monthly as the value of the Malagasy franc declined.

"Is that legal? It seems like the government keeps very close tabs on the exchange of foreign currency," Frank remarked. Jean-Paul shrugged.

Visits to Assess the Potential for Exporting Spices

Over the next several days, Frank tried to make appointments to speak with government officials, agricultural membership organizations, food processors, exporters and anyone else who he thought would have valuable information about the export potential for non-traditional spices. At the Ministry of Agriculture he hoped to obtain national production statistics but soon learned that the information available was inaccurate, outdated and incomplete. He also found out that the centralized or geographically concentrated cultivation of spices was declining in Madagascar, as the plantations once run by the French were either abandoned or extremely run down. Some spices were grown wild and harvested by independent peasants, so yields varied from year to year. Many plants from the large plantations had succumbed to disease, and those that grew wild often were damaged by severe weather and by the rampant deforestation taking place on the island, because they were not grown in a self-contained and protected area. The wide dispersion of spices also could pose a problem for processors, as the roads and communication infrastructure were almost nonexistent in many rural areas.

On the positive side, Frank was heartened to find out that spices were not restricted export products. Initially, he feared that they might be classified as protected flora, and therefore could not be exported except by special permit due to environmental regulations. Frank did have some concerns about the quality grade of the spices and whether it was comparable to those on the world market. He found out that there were government standards, set by the Ministry of Commerce, for most types of spices. However, these standards pertained to physical characteristics, such as the length and width of the vanilla bean, rather than the quality, growing and harvesting conditions. The majority of spices grown in Madagascar were exported, with 80% going to Europe. Frank hoped that boded well for the U.S. market, and that the Malagasy spices would meet U.S.

Exhibit 4

COUNTRIES OF DESTINATION FOR EXPORTS OF NONTRADITIONAL SPICES FROM MADAGASCAR

Ranked by Value of Freight on Board (FOB), 1993

Country	Quantity (kg)	%	Value FOB (1000 FMG)	%
France	1,096,803	35	1,971,797	32
Germany	469,833	15	1,088,027	18
Great Britain	471,346	15	721,459	12
Belgium	149,473	5	583,252	10
Netherlands	367,213	12	568,748	9
Reunion	68,557	2	171,382	3
Spain	87,221	3	162,850	3
South Africa	73,036	2	146,562	2
Poland	83,515	3	130,993	2
Italy	32,268	1	114,219	2
Soviet Union	12,500	0	97,170	2
Singapore	53,850	2	79,017	1
Tunisia	36,050	1	53,921	1
Nigeria	25,000	1	51,447	1
Niger	24,000	1	33,557	1
Denmark	3,730	0	28,963	0
Egypt	18,000	1	25,366	0
Comoros	22,627	1	17,536	0
Ghana	6,462	0	15,386	0
Sweden	1,259	0	7,804	0
Switzerland	300	0	4,899	0
USA	297	0	3,448	0
Austria	360	0	3,047	0
Mauritius	50	0	16	0
Malta	2	0	4	0
Monaco	1	0	1	0
TOTAL	**3,103,753**	**100**	**6,080,871**	**100**

Source: State Data Bank (BDE) Antananarivo

Average rates of exchange in 1993:
1 FF = 330 FMG
1 US$ = 1,900 FMG
1 ECU = 2,200 FMG

standards, which are typically the highest on the world market.

Meeting a Malagasy Businessman

Frank set up a meeting with the proprietor of a Malagasy spice processing company to learn more about the organization of spice production in Madagascar, and to gauge preliminary receptivity to the idea of forming a partnership with Summit Foods. He hoped to gain a better understanding of how the agricultural sector functioned, and what types of concerns Malagasy operators may have about working with an American importer.

Frank was early for his 2:00 p.m. appointment despite the traffic jam caused by market day in Antananarivo. He was offered a seat in a crowded office where five employees appeared to share one telephone and one typewriter. He noticed the office workers used and reused sheets of carbon paper to make copies of their work. At 2:15 p.m., Frank asked if Mr. Rakotomanana knew he was here. The workers exchanged glances and one of them told him he should be back shortly. Frank figured he may be tied up in traffic somewhere. All of the meetings he had attended so far had begun at least 20 minutes late. The Malagasy took lunch from noon until 2:00 p.m., and many returned home for the noon meal with their family.

At 2:55 p.m., Mr. Rakotomanana arrived. Frank was slightly annoyed because he realized he would probably miss his next meeting, scheduled for 3:30 p.m. He asked if he could use the phone briefly to call his next appointment. On his first few tries, there was no dial tone. One of the office workers volunteered to try calling for him so the meeting could begin.

After explaining who he was and Summit Foods' interest in spices, Frank spoke about his stay so far in Madagascar and asked for some recommendations about what tourist destinations he should visit. They discussed the weather, the local street market and the traffic, and Frank complimented Mr. Rakotomanana on his efficient staff. Frank was interested in touring Mr. Rakotomanana's processing plant but he did not yet feel comfortable asking to do so. Mr. Rakotomanana's manner was friendly, but still quite formal. Frank finally described in detail the techniques and processes used by Summit Foods, and asked Mr. Rakotomanana some basic questions about his operations. It was about 4:00 p.m. when Mr. Rakotomanana offered to take Frank on a tour.

The tour was brief, but Frank was impressed by how much they were able to produce in such small space with the unsophisticated equipment they used. He almost felt as though he were in a time warp. Many of the processes they used had been used in the United States in the 1940s and 1950s. Frank then asked some questions about the company's current customers and processing capacity: "You mentioned that your customers are all domestic. What is your current production capacity?"

"Yes. We like to produce for the Malagasy market. I cannot say for certain because our capacity depends on our customers. During harvest season, we hire temporary workers and they work longer hours until the work is finished," Mr. Rakotomanana explained.

"Are you interested in possibly producing for export as well?"

"Yes."

"Do you have the capacity to produce large quantities over a sustained period of time, for a large export customer such as Summit Foods, for example?"

"Yes. Of course." Mr. Rakotomanana seemed very definitive about that.

"Or would it be necessary to expand your operations, perhaps with the assistance of a partner like my company, through some sort of partnership agreement, to ensure you could meet demand?" Frank offered.

"Yes. I think that would be interesting," Mr. Rakotomanana eagerly replied.

"And your company would be willing to share in the capital expenses of such an expansion, if it were needed?"

Mr. Rakotomanana hesitated, and did not look back up at Frank. "I cannot say. This must be discussed with my family."

"Of course. I understand. I am only exploring the possibilities at this point. Do you think you might be interested in discussing this further at a later date?" Frank asked hopefully. He did not want to push too hard, but wanted to get a clearer indication of what this processor could do for Summit Foods, and on what terms.

"Yes. I think it would be interesting."

"I am leaving in about three weeks. Would you like to set up a meeting next week, after you have a chance to discuss things with your family?"

"Oh, yes."

"When would be convenient for us to get together again?" Frank inquired. He was beginning to feel his approach may be too aggressive.

"I must talk with my family."

"Can you call me at the hotel, or should I phone you later to set up a meeting?" Frank at least wanted a

definitive next step, since setting up the meeting had been so difficult to begin with.

"Yes."

Frank wasn't sure which question Mr. Rakotomanana was responding to.

"You can call me at the Madagascar Hilton?"

"Oh, yes."

"Or would you prefer that I call you?" Frank felt he might have a better chance of solidifying plans if he called Mr. Rakotomanana because he had already scheduled several meetings outside the hotel the next week.

"Oh, yes. I think that would be very interesting." The men shook hands and Frank departed.

As he left the building Frank thought to himself, "He certainly was an amiable guy, but a bit hard to read. Was he being realistic about his company's capabilities? He almost seemed too accommodating." Frank was not sure how well the meeting had gone.

Exhibit 5

ALTERNATIVE SOURCES OF SUPPLY FOR SPICES

Sales Prices Include Cost, Insurance and Freight

Spices	Origin	Unit	Price
Cinnamon			
sticks	Madagascar	kg	
pieces	Madagascar	kg	5,75 to 6 FF
ground	Madagascar	kg	11 to 12 FF
Mace	Indonesia	ton	2,375 US$
	Nouvelle Guinée		
Chili pepper	Togo	kg	18 to 25 FF
	Central Africa		
	Republic of China		
	Madagascar		35 to 60 FF
	Martinique		35 to 100 FF
	Morocco		8 to 10 FF
Peppercorn			
I. white	Sarawak	ton	1,525-3,750 US$
	Sarawak DW		1,525-3,750 US$
	Muntok		1,525-3,750 US$
	Brazil		1,900-3,300 US$
II. black	Lampong	ton	1,050-1,895 US$
	Sarawak		1,000-1,835 US$
	Brazil		1,000-1,700 US$
	Madagascar		1,050-1,700 US$
Ginger	Brazil	kg	9-22 FF
	Thailand		12-19 FF
Chili pepper,	Morocco	kg	6-10 FF
green	Madagascar		30-60 FF
	Martinique		30-100 FF

Source: Marchés Tropicaux et Mediterranéens, 1993

Assessing the Credit Market

Frank ran into Jean-Paul at the Hilton on his way into the dining room, so they decided to have a drink together before dinner. Frank wanted to know about the commercial loans market in Madagascar. If he were able to set up a partnership agreement or close a long-term deal with a Malagasy processor, the processor would most certainly need to expand in order to handle Summit Foods' business. Frank preferred to deal with one or two large suppliers rather than dozens of smaller ones, and he was fairly certain there were few, if any, with enough production capacity to take on a customer such as Summit Foods while continuing to serve their current customer base.

"What can you tell me about the credit situation here?" Frank asked. "I know the national government is far outspending its receipts and I'm sure that affects the availability of credit here. Did your company finance anything locally?"

"The banks here are extremely risk averse. Even so, they still have many nonperforming loans in their portfolio. We didn't need to use any local banks for financing but we use a Mauritian-owned bank for our accounts payable and our payroll because we don't have a lot of faith in the local banking institutions. Two of the five banks are still partially owned by the Malagasy government, although they're in the process of privatizing. Until that happens, we'll stick with Union Commercial Bank."

Jean-Paul went on to explain that the prime rate was set by the Banque Centrale, which serves much the same purpose as the Federal Reserve Bank in the United States. The five commercial banks then set their rates accordingly.

"Just out of curiosity, what is the current rate to commercial borrowers?" Frank asked.

"Twenty-three percent," Jean-Paul answered, grinning.

"No, really." Frank laughed.

"I'm dead serious, Frank. And they require a 50% guarantee."

"A guarantee? What do you mean? How does that work?"

Jean-Paul explained that a borrower must deposit 50% of the total amount of the loan in the bank, or commit some other type of collateral that is acceptable to the bank.

Frank was incredulous. "That's crazy. If you had the money to begin with, you obviously wouldn't need the loan."

Jean-Paul shrugged. He went on to explain that banks and other funding institutions depended a great deal on a borrower's reputation through word of mouth. There are no formal credit bureaus in Madagascar. Knowing the "right" people was essential.

Frank now understood the capital constraints firms like Mr. Rakotomanana's were facing. After Frank described his earlier conversation with Mr. Rakotomanana, Jean-Paul explained the concept of *fihavanana*, or family harmony, which was central to Malagasy culture. "It is a critical decision-making factor in all family decisions. Preserving the *fihavanana* is of great importance in this culture, and it often leads to 'uneconomic' business decisions. You are not dealing with what economic theory traditionally refers to as "rational actors." What makes perfect business sense to you may not even be a consideration to your Malagasy colleague."

Jean-Paul had another appointment, so Frank ate alone that night. Over dinner he considered what he had learned about doing business in Madagascar during his first week, and what additional information he would need before he left the country in three weeks. He was scheduled to receive a call from Martin Herlihy tomorrow morning to give him a progress report.

Madagascar was eight hours ahead of the United States, so Martin would likely be calling around 6:00 a.m. local time. Frank wanted to think through the pros and cons tonight so he would be clear headed tomorrow morning when the call came through. He knew Martin would be interested in "the numbers," but there were so many other nonquantifiable factors that warranted as much if not more consideration than the numbers. He was not even at the stage where he could discuss production volume, profit margins and freight costs. Frank was not sure how to present what he learned thus far because, since Martin had not visited the country, he would not easily grasp the business environment nor see both the potential opportunities and obstacles to doing business in a developing country such as Madagascar.

NOTES

1. This case was written by Valerie VinCola of Emory University. It is intended as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

Box-It, Inc[1]

Casablanca, Morocco

Like most days, it was not difficult to explain the cause of the commotion in the building. Mr. Abdul, the president of Box-It, a corrugated carton manufacturer on the outskirts of Casablanca, had arrived several minutes before with an Italian consultant who had come to the country for his quarterly visit to the plant. But the anticipated arrival of Mr. Abdul's son, Hassen, known for his severe management style, was the real cause of panic. Shuffling back and forth, workers did whatever possible to appear busy, in many cases even repeating work completed earlier, which explains why the corrugater[2] was being oiled for the third time that day.

After a short walk around the plant, Mr. Adbul led the consultant into his office, closed the door, and turned around with a seldom seen look of despair on his face. "As you know," Mr. Abdul began, "we've had trouble remaining competitive. Our costs are just too high! I've been over this again and again with Hassen. He wants to build a new plant in order to make our own raw materials from recycled paper, claiming that we'll be able to lower costs and achieve economies of scale. Backward integration? I don't know. I'm too old to start over again. If we could just find an easier way to lower our costs, I would be much happier."

Pulling into his usual spot in the parking lot with the driver-side door open and his left leg hanging out, Hassen reached for his cellular phone and shouted, "Bring me the sales figures." (Exhibit 1) When the car finally came to a stop, he jumped out and with a running start headed toward the building. With one hand holding the phone to his ear and the other fully extended, he shoved open the door and quickly climbed the stairs leading to his office.

By the time the secretary brought in the mail and messages, Hassen, in the presence of the Italian consultant and the finance director, was already in a disagreement with his father. It quickly turned into a tug-of-war.

Hassen said, "We need to create our own paper manufacturing plant! Over the last three months, the cost of raw materials has increased substantially. I'm not just going to sit here and watch us sink!" He moved swiftly toward the door, pulling the arm of the finance director and motioning him to leave with him. "Call the bank immediately," Hassen instructed him, "and ask them to approve the loan for this year!" "Okay," said the finance director.

"Wait a second," Mr. Abdul said, slightly angrily. "That's ridiculous. Come back, let's talk about this . . ." The Italian consultant nodded in support of what Mr. Abdul was saying. Moving to catch the two in the hallway, Mr. Abdul grabbed the free hand of the finance director. "Forget calling the bank!" he ordered. "Okay," said the beleaguered finance director.

But Hassen pulled the arm of the finance director more firmly while raising his voice. "No, no, no," he insisted. "Call the bank, bring me the proposal and let me talk to them."

"Okay," agreed the finance director, although he could be barely heard over the shouting.

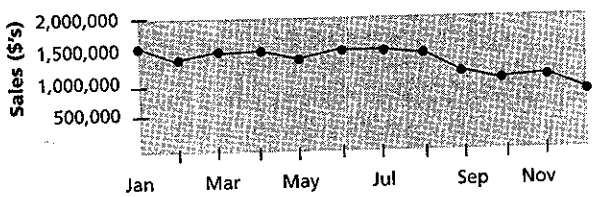
Mr. Abdul clamped both hands firmly on the arm of the finance director and raised his voice to match his son's. "NO! Don't call the bank!" he shouted. The argument continued for another 30 seconds. Not knowing to whom to say "okay," and with his arms being pulled in both directions, the Finance Director's eyes began to bulge. Finally Mr. Abdul grew tired and slowly released his grip. He restarted calmly, "We'll never know if we're making the right decisions until we understand the nature of our costs."

The Italian consultant looked surprised, as if in his 20 years in business he had only seen this type of action in a classical Roman theater. Convinced that it was too late to make a run for it, he sat back in his chair and smoked a cigarette. The others composed themselves and sat down. Mulling over Mr. Abdul's comment about their need to understand costs, they thought about how to design a product costing system suitable to Box-It's operation.

Exhibit 1

BOX-IT'S 1994 MONTHLY SALES (in US dollars)

Jan	1,552,000
Feb	1,392,900
Mar	1,478,400
Apr	1,481,700
May	1,396,100
Jun	1,509,900
Jul	1,502,300
Aug	1,460,500
Sep	1,209,300
Oct	1,091,734
Nov	1,146,093
Dec	900,084



The Abdul Family and Box-It: A Brief History

Thirty-two years ago Mr. Abdul, then a well-respected colonel, left the military to start a career in the private sector. At the time he did not count on having to change his life so dramatically. After relocating his family from the imperial city of Rabat[3] to join an oil company, working longer hours, and now taking orders from various middle-level managers, he wondered what else would change. Soon it became evident: despite his notable flair for doing business, his Moroccan nationality and lack of a college degree would prevent him from entering the upper echelons of the U.S. multinational that employed him. Convinced nonetheless that the private sector offered the best opportunity for his family, and eager once again to be in a position of command, he founded a small cardboard transformation business[4] in 1971 and ran it on a part-time basis. With the hope of making enough money to send his kids to foreign schools for a quality education, he was pleasantly surprised in 1975 when his business prospered. He was able to leave his job and once again become commander in chief, this time of his own operation.

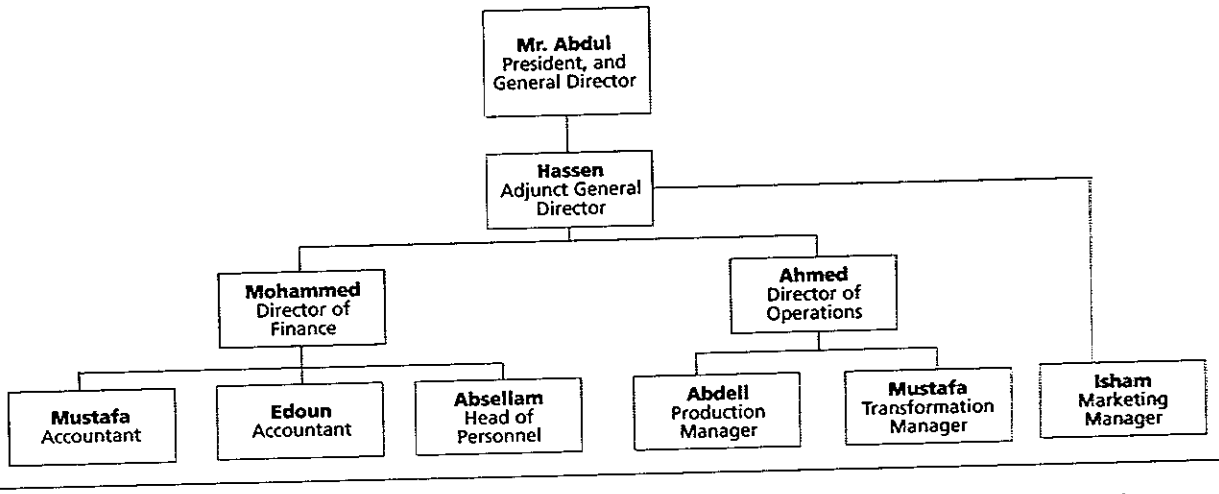
Years passed, and the business and family grew. In 1992, Mr. Abdul's son, Hassen, returned to Casablanca after years of overseas study. Still awaiting the results of his final exams from his last semester at an American business school, Hassen arrived at the airport to an emotional family greeting. Mr. Abdul, proud to have his only son back home, led him by the hand to the car to drive him to an undisclosed location. Hassen had been away three years, but though Casablanca had changed in the interim, it was hardly enough time for him to forget his way home. But Mr. Abdul took a different route, piquing Hassen's curiosity by purposely not explaining where they were headed. Speeding through the countryside, Mr. Abdul occasionally gestured to military and police officials standing at attention to salute him from the roadside. After 32 years he was still remembered by most people as Colonel Abdul, which brought a nostalgic smile to his face as he squinted and concentrated on the changing road conditions in the near distance.

Quickly hitting the brakes as the road narrowed into a long gravel stretch marking the beginning of the industrial quarter of Casablanca, Mr. Abdul slowed so as to view the entirety of what was ahead. Workers were putting the finishing touches on a new 6,000 square meter factory. On the second floor, in an office next to his father's, Hassen found a stack of business cards with his name and new title, Adjunct General Director. (Exhibit 2 presents the organizational chart for the business.) Hassen sat down in the reclining chair in his new office, determined to learn all he could about the corrugated cardboard manufacturing business. He resolved to begin running Box-It with one strategic objective in mind—not letting his father down.

Now, three years later, Hassen felt he had learned the business and could run it on a day-to-day basis. His father now spent most of his time downtown dealing

Exhibit 2

BOX-IT ORGANIZATION CHART



with another part of the family-owned operation, leaving the company's operation in the hands of his son.

Corrugated Cardboard Manufacturing

Cardboard manufacturing consists of two main stages: production—converting/corrugating raw materials, and transformation—transforming semifinished product. There was also an optional third stage: finishing, technically a part of transformation, depending on the customer's needs. Photographs of the operation appear in Exhibit 3.

At the production stage, 1.5 ton paper reels are fed through a 1,500 foot-long corrugating machine operated by 17 employees. Following international standards, the corrugater produces cardboard containing three or five layers of paper with varying degrees of frequency in the middle corrugated layer. The number of layers, their respective weight and the frequency of the corrugations determine the strength of cardboard. Although rarely requested, boxes could be designed to resist as much as 3,000 pounds of external pressure. After being glued and pressed, cardboard passes through a two-system cutting process. First, manually calibrated scores (blades) cut lengthwise down the cardboard to trim off excess waste. Second, synchronized rotary blades at the end of the production line cut along the width of the cardboard to supply the quantity of flat cardboard sheets needed to fill an order. The resulting semifinished product is stacked in a reception area for transformation.

Cardboard transformation then occurs on one of ten machines, based primarily on the complexity of the customer's order. Each sheet of cardboard fed into a transformation machine passes over a die-cutter which stamps on a colored impression (usually a company logo) and cuts the cardboard to precision for proper folding. Several of the machines are capable of transforming 10,000 boxes an hour. Before exiting the transformation stage, cardboard is either glued or stapled to hold its final box shape, although the final product is usually shipped to the customer in knocked down position (or flattened form) to save room during transportation.

Occasionally for customers without automated, on-site loading machines, knocked down boxes from transformation are passed through finishing, where they are converted into their upright box shape.

Finally, finished products are moved on palettes to the loading and shipping area for customer delivery or pick-up.

Designing a Product Costing System

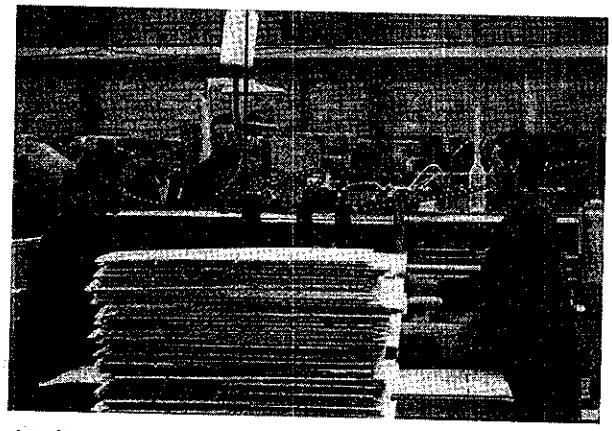
Shortly after the visit of the Italian consultant, a meeting was called to determine how to obtain more detailed and accurate product costs.

CURRENT PRODUCT COSTING SYSTEM

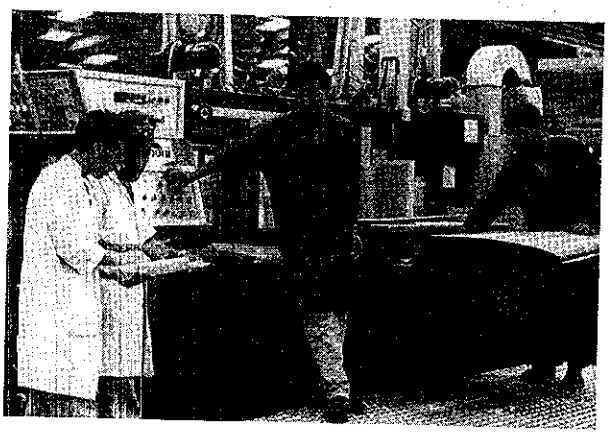
Hassen and Mr. Abdul, seated at opposite ends of the table, started the meeting speaking at the same time. Half the table focused attentively on Mr. Abdul while the other half nervously faced Hassen. A week had passed since the tug-of-war in the hallway, but to the finance director, who still vividly recalled how he was literally pulled in opposite directions by the two men, this beginning was exasperating. Seated next to Hassen, he appeared ready to blurt out, "Please God, don't let it happen again!" After the initial confusion, however, Mr. Abdul gave way and motioned Hassen to proceed. Far from the topic of product costing, Hassen began talking angrily about a quality control issue: "This is intolerable, I won't stand for it. I can't afford to lose

Exhibit 3

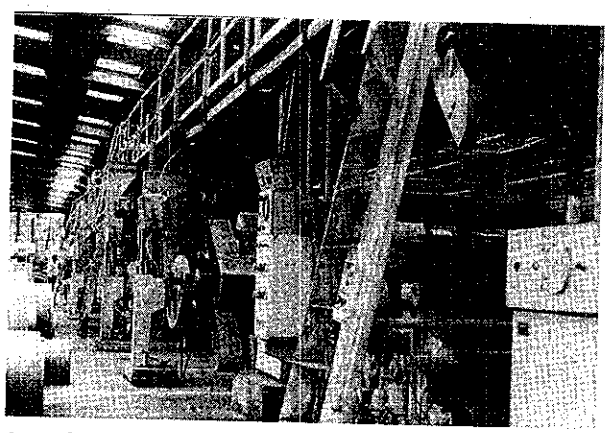
BOX-IT PRODUCTION OPERATION



Machine corrugating and gluing paper to make cardboard sheets



Quality control team inspecting semifinished product at one of ten transformation machines



Transformation machine processing cardboard into finished product

Loading finished goods onto company vehicle for delivery

another client because of incompetent mistakes." The truth was that the average quality control problem represented less than a 1% defect rate, a significant improvement due to the brilliance of the new director of operations, Ahmed. Prior to his arrival at Box-It, defect rates of ten percent had forced the company to produce large safety margins to fill each customer's order. Poised to respond to Hassen's comments, Ahmed leaned forward in his chair. But before he could speak, Hassen continued in a louder, harsher voice, "If you can't do your jobs, I'll hire someone who can! Just look out the window. There are plenty of people waiting to take your places." Suddenly with a look of discouragement, Ahmed slouched back in his chair and took a deep breath.

Before getting much farther, Hassen was called out of the conference room to take a telephone call. The air seemed lighter and everyone appeared much more relaxed. Mr. Abdul continued the meeting and was only temporarily disturbed when Hassen called and asked if he could see the finance director. As the finance director headed towards the door, Mr. Abdul said in a low voice, "Don't spend more than five minutes with him." Returning to the issue of product costing, Mr. Abdul spoke of the rising costs of raw materials, increased machine down-time, stagnant production, the loss of important clients and the overall need for a more reliable product costing system.

Until now, unit product cost, known only by Mr. Abdul, Hassen and the finance director, was determined by dividing total monthly expenses by monthly production levels (see Exhibit 4). Unit product cost always declined toward the end of the year because monthly expenses were recorded on a cash basis. No effort was placed on capturing cost differences stemming from different setup times or design phases, even though these clearly affected indirect labor costs. There was also no effort to track varying color/logo stamps or box complexity, even though these clearly affected ink, glue and staple consumption. In short, Box-It's costing system treated all

boxes equivalently. This approach made Box-It's products the most expensive in the industry, since all boxes were sold at the same price, adjusted only for different paper raw material costs. In most cases, Hassen justified the high prices by pointing to constant increases in the cost of raw materials, Box-It's commitment to quality, and the firm's excellence in on-time delivery.

Customers kept fleeing, however, looking for lower cost producers. Finally a very large, well-known European multinational—Box-It's largest customer account—demanded that Box-It lower its prices. The customer claimed that many of Box-It's competitor's offered better prices and comparable quality and delivery times. Hassen could hardly believe his ears. How could any of his competitors sell at a significantly lower price? Convinced that Box-It was already selling at cost and afraid to incur substantial losses, he refused to reduce prices. He was, after all, aware that many firms used this type of bluffing technique to receive rock bottom prices and squeeze their suppliers. In a matter of days, though, reality struck a tough blow. The multinational sent a letter stating they would no longer use Box-It as a supplier. Unlike losing other customers, the loss of this account brought an urgent need to reconsider Box-It's corporate strategy.

SETTING A NEW CORPORATE STRATEGY

Mr. Abdul and Hassen sat together discussing the impact of this lost account. The declining sales figures were worrisome, and both knew that the new year had to be different if Box-It were to grow. With vastly different ideas as to what needed to be done, Hassen leaned back in his chair and began discussing his ideas, which involved firing several people, extending operating hours to include Sundays and building a new facility to produce raw materials. "No, I won't require anyone to work on Sundays," responded Mr. Abdul with disappointment, as he seemed more concerned about the general direction of the company since the multinational account was lost. After many hours of discussion, a new strategy was determined and it became the subject of the annual meeting held two weeks later.

Exhibit 4

INCOME AND PRODUCT COSTING STATEMENT
(USED FOR FINANCIAL REPORTING AND INTERNAL MANAGERIAL USE)
(in U.S. dollars)

	Oct-94	Nov-94	Dec-94
Net Sales	$1,091,734	$1,146,093	$900,084
Expenses			
Raw Material	739,960	735,423	514,699
Supplies	29,055	24,947	23,863
Gen/Adm	34,502	33,288	49,518
Taxes	2,442	2,438	2,439
Personnel	48,412	47,495	47,328
Currency (Gain)/Loss	0	28,750	0
Depreciation	84,498	85,089	85,066
Interest	65,000	65,000	65,000
Total Expenses	$1,003,869	$993,680	$787,913
Income	$87,865	$152,413	$112,171
Total Monthly Expense	1,003,869	993,680	787,913
Total Monthly Production	978,742	925,287	848,891
Unit Product Cost	$1.03	$1.07	$0.93

Mr. Abdul began the annual meeting, attended by the sales/marketing staff and company executives, declaring, "Box-It's marketing strategy needs to be reconsidered." In agreement, Hassen interrupted with the following comments, which became Box-It's marketing strategy for the current year: "In fact, the year we're beginning is a year of marketing. That is to say, a year of large contracts which will allow Box-It to optimize its productive capacity, which is currently below potential. Box-It has already entered some of the toughest markets, which is proof that our marketing force is key to our survival. Our marketing objective consists of keeping our already well-founded relationships with certain clients and going to the next stage of development, while at the same time moving away from clients who cause us nothing but grief. With the experience we have now acquired, we can produce a new product aimed at low-end and middle-end customers. Our pricing policy will continue to consist of setting new prices as soon as costs change in the market."

The strategy required that the company develop and commit to new product costing methods to adjust prices quickly in the face of changing conditions.

THE NEW COSTING SYSTEM

The new costing system was laborious to develop, for it had to focus on activities performed rather than total monthly expenses, and this meant the internal accounting and reporting system had to be restructured significantly. When the idea of activity-based costing was first presented to Mr. Abdul in mid-February, he commented hesitantly, "Would a computerized pricing system based on monthly activity cost be too rigid for Moroccan consumers?" After all, Moroccans were not used to Western-style price tags with fixed prices. Instead, prices were usually negotiated at length until both parties agreed, often through a haggling process that could last hours. Mr. Abdul gathered his thoughts, then reared back in his chair and proclaimed his decision: "Regardless of how prices are negotiated in the market, we must develop a new product costing system. Even if market forces mean we occasionally sell at a loss, that's fine, as long as we know when we do it, and as long as we know what the overall impact is." The others nodded silently and began developing a project action plan, detailing meeting times, objectives, work groups and responsibilities.

A new emphasis on measurements from the factory floor and away from departmental estimates ensued as metering equipment was installed on all machines to measure material input and product output. Stopwatches were used to calculate setup times for each production order and cardboard was weighed at various stages of the production cycle to calculate glue, ink and staple consumption. The first draft of the study revealed that two transformation machines were operating inefficiently and far below capacity. Several solutions were proposed, including the alternative of selling the machines and outsourcing. After the first six months, one of the accountants noted he had spent more time in the factory during the past six months than during his previous two years with the company.

Over time, each major cost-incurring activity of the company was examined (direct labor support, machine operation, shipping, product design and quality and general administration) with an eye toward how much it cost. Appropriate cost drivers, including direct labor dollars, machine hours, number of shipments and the number of production orders received, were determined for each activity and later used to apply overhead costs to products. Exhibit 5 presents that analysis and the proposed new overhead cost ratios.

THE RIPENED PRODUCT COSTING SYSTEM

Once the system was built, Mr. Abdul sat alone in his office reviewing the new product costing reports as the steamy August heat filtered through the window. He could now calculate costs using this new Activity-Based Costing (ABC) system and compare the results with numbers produced by the old method which had long served as the basis for setting prices charged to major clients. Using information from Exhibit 5, he realized that the ABC system reported lower cost allocations than had previously been charged to many Box-It customers, including the multinational account just recently lost, implying that Box-It could profitably lower prices. Happy with his findings, Mr. Abdul jumped to his feet to bring Hassen the results.

It was clear to him that this new product costing system could revolutionize the way Box-It conducted its business. Customers who called to place orders could immediately be quoted computer-determined prices calculated based on monthly activity-cost studies. These figures would be much more accurate than costs previously reported by the company's old costing system.

BACKWARD INTEGRATION INTO PAPER MANUFACTURING

Mr. Abdul's exit was interrupted by the director of operations, who entered Mr. Abdul's office to show him the plan for the proposed paper manufacturing plant—the one that had caused such disagreement between Mr. Abdul and Hassen. Mr. Abdul's complacent smile disappeared as soon as he realized what the director of operations held in front of him.

Eighty percent of the paper used in Morocco for cardboard production were virgin fibers imported from Europe. The remainder was recycled paper supplied by local producers. Hassen believed a recycled paper manufacturing plant could meet Box-It's needs for recycled

Exhibit 5

OVERHEAD ALLOCATION (USING NEW, ACTIVITY-BASED COSTING SYSTEM)

	Direct Labor Support Activity	Machine Operation Activity	Shipping Activiy	Product Design & Quality Activity	General & Administration Activity
Overhead					
Maintenance	$3,550	$16,253	$4,850	$575	$ -
Machine Set-up	0	5,956	0	0	0
Salaries	8,855	9,800	1,743	1,283	65,100
Depreciation	0	48,263	6,540	890	28,530
Scrap	0	6,212	0	0	0
Employee Benefits	3,005	19,850	842	360	13,070
Gen/Adm/Misc.	1,800	11,300	379	985	15,550
TOTAL OVERHEAD	$17,210	$117,634	$14,354	$4,093	$122,250
Overhead Base*	24,612 DL$	1755 Machine Hrs.	195 shipments	325 PO's	$177,903Value Added
Overhead Rate	**71%**	**$67.03 per hr.**	**$73.61 per shipment**	**$12.59 per order**	**68.7% G&A/Value Added**

Product Costing Info.: Multinational Account	
Material Cost per unit	$0.24
Direct Labor hrs./per unit	0.0035
Machine hrs./per unit	0.0028
Labor rate/per hr.	$0.67
Volume	10,000
Shipments	1
Production Orders	1

Value Added Calculation
$24,612 DL$'s
$17,210 DL Support
$117,634 Machine Oper.
$14,354 Shipping
$4,093 Product Des &Qlt'y
177,903 Value Added

* Overhead base uses the following cost drivers: direct labor $'s (DL$), machine hours (Machine Hrs.), number of shipments (Shipments), number of production orders (PO's) and Gen/Admin as a percent of Value Added (G&A/Value Added).

paper and supply other companies in the country as well. Box-It would use 20-50% of its output and gain better control over paper costs. The plant would be 75% financed by a bank loan, and though an internal rate of return calculation suggested the plant might not be a good investment, Hassen felt strongly about the need for a reliable source of paper with prices under his control.

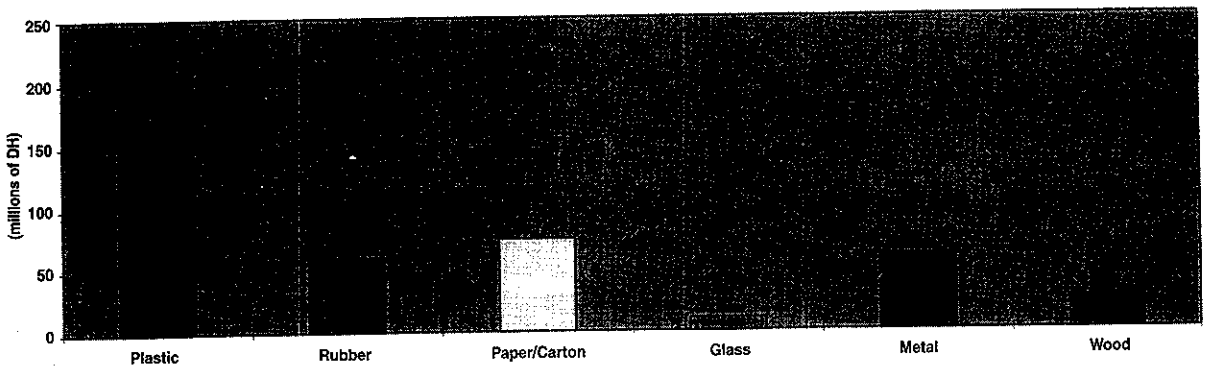
Returning to his desk and sinking in his chair, Mr. Abdul pointed to the gray in his hair and said in an agonizing voice, "I'm getting old. I don't know if this is the right thing to do." Believing that Mr. Abdul was not asking his opinion but rather seeking his encouragement, the director of operations responded: "Paper manufacturing is the wave of the future. We'll be one of the first to do it in Morocco. We'll kill the competition."

At the same moment in the adjacent office, Hassen was yelling into the phone. "I don't care about the building laws and your people's lunch hours. That's your problem! My problem is seeing to it that my raw material

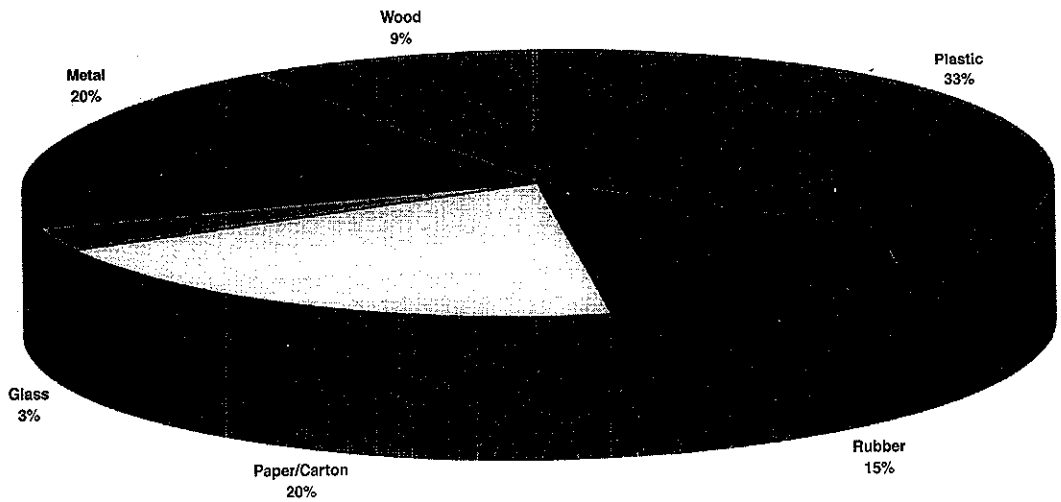
Exhibit 6

THE PACKAGING INDUSTRY: INVESTMENT AND OUTPUTS

1992 Packaging Industry: Investment by Sector



1992 Percentage of Output by Packaging Sector



production plant is completed on time. The ground breaking crews will be here Thursday morning, and you'd better be here by noon!" Hassen, dreaming of running his own empire before he reached his father's age, turned his attention to calculating his staffing needs for the new production facility.

Study Questions

(1) Discuss Box-It's competitive position and the impetus for an alternative costing system. Consider its likely impact on some traditional ways of Moroccan business.

(2) Consider the order from the multinational that closed its account. Compare product costs for the order using information from both (a) the old cost system and (b) the new ABC system. Assume that the multinational had offered to pay $.80 per box. Should Box-It have accepted this offer?

(3) What are the benefits of the new ABC system?

(4) How could the current financial reporting system be made more effective for managerial decision making?

(5) What recommendations would you give to help Box-It improve the overall management of the firm?

(6) Compare the income statement in Exhibit 4 with income statements prepared under GAAP. What are the differences and similarities?

(7) What issues should Box-It consider before deciding to backward integrate into paper manufacturing?

(8) Discuss other factors possibly affecting Hassen's decision to vertically integrate, as suggested by his final comments in the case.

Appendix

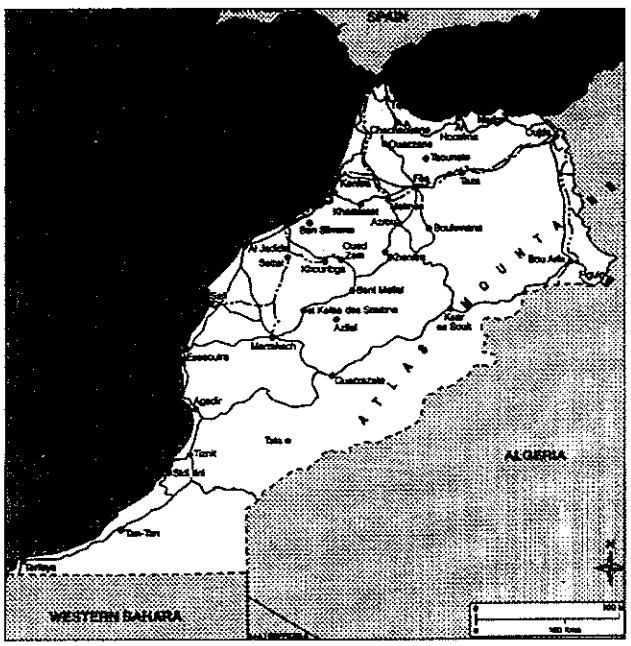
Country Background

Geography

Situated in the northwest corner of Africa, the Kingdom of Morocco is about the size of California and is separated from Spain by the Strait of Gibraltar. Sharing borders with Algeria and the disputed area of the Western Sahara,[5] Morocco in the Arabic language (El Magreb el Aqsa) means the extreme west of the Arab world. Morocco is dominated by the highest and most rugged mountain chain in northwest Africa, the Atlas Mountains. Encircled by the mountains are the coastal plains and plateaus, home to Morocco's major cities. South of the mountains, Morocco melts into the hot Saharan Desert, sparsely inhabited by nomads on scattered oases.

Exhibit 7

MAP OF MOROCCO



History

Morocco's strategic location as a gateway to Europe gave rise to a series of invasions by early civilizations. Berber tribes, believed to be Morocco's first inhabitants, lost control to Muslim warriors in the early eighth century. Fighting off Arab rule and Islam, the Berbers remained a reckoning force until the 13th century. Other invasions followed, but by 1649, with the birth of the Alouite Dynasty,[6] Morocco became more united and stable than ever until the French Occupation.

Once again considered a gateway, this time to Africa, Morocco finished the 19th century fending off European interests. Several events proved Moroccan forces too weak to protect their national borders, including a Spanish victory in the Moroccan-Spanish war of 1860 and the 1888 Spanish proclamation that it was the protectorate of certain Moroccan cities. By 1900, France and Spain had made official agreements dividing the land. Spain's interests were primarily in protecting its own borders off the northern coast of Morocco,[7] while France was more interested in expanding its colonial reign already present in Algeria and Mauritania (Morocco's neighbors). Other European powers were interested as well, however. Great Britain was ready to intervene, but when a German gunboat suddenly appeared off the southern coast of the country, an international crisis erupted. France prevailed eventually because of its settlements, and both Great Britain and Germany recognized Morocco to be within the French sphere of influence.

In 1912, when Morocco became a French protectorate, nationalistic sentiments abounded. Several rebellions were subdued, but France's exile of Sultan Mohammed ibn Arafa in 1953 led to violent protests. Weary from World War II and in desperate need to rebuild the country, France brought back the exiled Sultan and recognized Moroccan independence in 1956.

Economy

Historically Morocco's most important export industry both in tonnage and value is phosphate and phosphate-related products. In fact, Morocco is the world's third largest producer of these products and has the world's third largest deposit of phosphates. Generating only $1.3 billion in 1990, however, the phosphate industry faced a new set of business conditions—volatile prices on the world phosphate market and a shortage of skilled workers, to name a few. Headed for disaster with unpredictable revenues and a labor force unable to keep pace with rapidly changing technology, Morocco turned its emphasis to its agricultural sector to circumvent the ill effects of this chemical extraction industry.

Like most developing economies, however, Morocco's 26.7 million inhabitants are overly dependent on agriculture. Agriculture employs 50% of the workforce and accounts for 16% of GDP. Principal agricultural exports include citrus fruits, fresh vegetables, dried peas, beans and olives. Hard hit by decreases in annual agricultural output, long drought seasons and a shortage of arable land, Morocco's weary agricultural sector has not been able to balance out the troubled phosphate industry; indeed, it is troubled itself. Concerns about the long-

term viability of agriculture have reached the royal palace. This was demonstrated during a nationally televised event in early 1995 when His Majesty the King Hassan II asked God for rain, fertile soil and a replenished crop.

In recent years the importance of agricultural and phosphate products as a percentage of GDP has declined, as the government—with its break or bust strategy—aggressively sought ways to re-orient the economy. One major step in that direction is the privatization underway affecting 111 state entities valued at $2.5 billion. Other examples include the textile and automobile assembly industries, which are emerging due to increased European demand for lower labor costs in manufacturing these products. Most of this demand comes from France, Morocco's largest trading partner, which purchased about 30% of Moroccan exports in 1992.

Packaging Industry

Morocco's packaging industry includes metal, wood, glass, paper/carton, rubber and plastic packaging manufacturers. It is composed of 345 primary manufacturers and several hundred secondary enterprises specializing in various levels of outsourcing, such as transformation of semifinished products and distribution to end users. The majority of firms are Moroccan-owned, but large profit potentials have attracted many neighboring European firms. Overall, the packaging industry accounted for 5% of industrial productivity, employed nearly 23,000 workers and contributed 5.7 billion dirhams[8] to GDP in 1992. Most of the activity centered around plastic packaging. However, a five-year study published by SIPEC[9] in 1995 suggested that the paper/carton sector is quickly evolving.

SIPEC '95 highlighted the fact that nine Moroccan carton/paper manufacturing companies serviced the local market and provided 85,000 tons of cardboard in 1992. A considerable number of secondary enterprises (especially transformation and printing outfits) are active in the market as well. Fifty-two percent of all raw materials used in cardboard manufacturing are imported from Europe. Cardboard production from 1988-1992 increased by 71%. Sales, investment and the number of persons employed in this sector all have increased significantly since 1988.

NOTES

1. This case was written by John Rountree of the University of Wisconsin-Madison. It is intended as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

2. Machine used to corrugate paper in the production stage of cardboard manufacturing. (See section on corrugated cardboard manufacturing and the photographs in Exhibit 3.)

3. In addition to being one of the four imperial cities of Morocco, Rabat is also the nation's capital.

4. Cardboard transformation businesses specialize in the transformation of semifinished cardboard sheets.

5. After Spanish withdrawal in 1976, Morocco claimed control over this area based on their territorial boundary in medieval times. The existence of considerable phosphate deposits also attracted Algerian and Mauritanian interests in controlling the Western Sahara. After 15 years of war, the United Nations proposed a cease fire agreement in which a referendum would determine Western Sahara's official status. The referendum date has been postponed and at the time of this writing has yet to be determined.

6. Morocco's 350-year-old Alouite Dynasty claims descent from the Prophet Mohammed. It is the oldest Monarchy in the Arab world, currently represented by King Hassan II who has been king since 1961.

7. Two Spanish enclaves in the north of Morocco (Ceuta and Melilla) still exist today under Spanish administration.

8. Dirhams are the official currency of Morocco. 8 dh = US$1.

9. Salon International des Plastiques, du Caoutchouc, de l'Emballage, et du Conditionnement.

ZATON S.A.R.L.[1]

Fés, Morocco

It seemed like a re-enactment of a scene from the motion picture The Last Action Hero. In that story, detective Jack Saltier (played by Arnold Schwarzeneger) receives a phone call from his ex-wife who begins a conversation that is all too familiar. To get on with his work, he plays a cassette tape labeled "The Shrew" and lays the phone's mouthpiece next to the speaker. The tape continually plays "uh-huh, uh-huh, yeah, yeah, yeah," and the ex-wife continues her end of the conversation oblivious to the man's absence.

A few years later, and six thousands miles away, a similar scene was taking place in the offices of ZATON, an agricultural export firm located in Fés, Morocco. There the situation was a little different, of course; ZATON had recently lost on exports only a small fraction of the money Columbia Pictures lost on that movie. And there was no tape recording device actually in use here, but the same kind of repeated assurances and agreements were uttered unthinkingly. This Moroccan conversation also took place in French and Arabic, rather than English. Instead of Schwarzeneger uttering the lines, it was Abdul Abdul, the Managing Director of ZATON S.A.R.L., who was placating his client with "oui, oui, wacha (Arabic for OK)." In the meantime, he continued his conversation with his recently arrived American FMDAP adviser, only to return to the phone every few moments to repeat his assurances.

"Every week we have the same conversation. I know exactly what he is going to say and I keep giving him the same response. He's upset because we haven't processed his order yet. The problem is that he wants lithographic tins, and our manufacturer says that the boat carrying the raw materials sank en route from Spain. I want to confirm this with the shipping company, but our manufacturer won't give me their name. He says that it's his problem, not mine. I think he's processing the material for someone else. Meanwhile our clients are frustrated because they're running out of stock."

Abdul's company was facing multiple problems in its operation. The firm had expanded rapidly in recent years and that was taking a toll on the finances and management of the company. With a new factory on the outskirts of Fés, and the recent acquisition of a local competitor, ZATON had more than tripled in size. This was posing immense challenges for this tightly-held family-run business. Compounding the problem, the company was now pursuing joint ventures with Spanish, Italian and Turkish firms.

The results of these initiatives surprised Abdul. Instead of spending the majority of his time in the factory supervising production, he was now locked behind his desk answering the increasing volume of questions and complaints from clients, agents and suppliers. Quality control had become a concern due to the age and lax maintenance of his factory equipment, and personnel problems were disrupting both key managers and unionized employees.

History of ZATON and Present-day Conditions

ZATON S.A.R.L., was started in 1974 by Mr. Maleh Sr.. His motivation for starting the company was to give himself

Exhibit 1

PROFILE OF ZATON

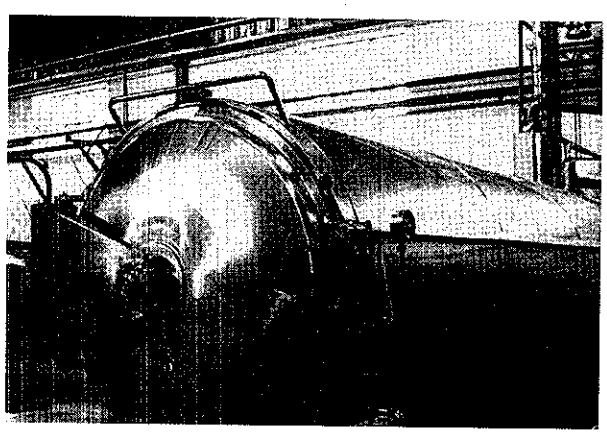
Managing Director of ZATON

Using manual methods to dig a well

Using a horse-drawn cart to deliver equipment

Inspecting plants grown under cover to shield them from the sun

Adjusting machinery to close cans



Using sophisticated equipment to sterilize crops

something to occupy his time. He had recently retired from government service as the former vice governor of the Fés region, and now sought an outlet to continue leading an active life.

In 1984 his oldest son took control of the company, and he has been its managing director ever since. Before coming to work for ZATON, Abdul had been in academia. Assisting him in running the business was his brother Karim. The two of them made most decisions concerning the factory. In addition to the two brothers, other members of the immediate family were partners as well. Though he had to please them as business partners, Abdul was the key decision maker. Family meetings were chaotic but controlled; everyone had a say, but Mr. Abdul and Karim always prevailed.

ZATON was located in the industrial quarter of the city. Over the years the factory had changed dramatically. When it opened, the factory did not even have lights for the 6,400 square meter facility. Over the years the family acquired a vast array of machines, ranging from used can closing machines to state-of-the-art sterilizers. Overall the factory was unimpressive equipment-wise, but Abdul's strength was that customers and clients preferred dealing with him over larger companies.

The company currently produced green and black olives, capers, flame roasted red peppers, pepper paste, onions, artichokes and garlic. Its markets were primarily overseas with a large portion of the products going to Europe. In 1992 the company began exporting to the United States and Canada.

In addition to expanding product lines, Mr. Maleh Sr. began expanding production facilities. In 1994, ZATON opened a new factory on the outskirts of Fés called Sunray. Though the new company had been founded in 1990, it existed only on paper until plant construction began in the summer of 1994. The company was set up as a receiving station for olives and capers. Here, freshly picked olives and capers were delivered, cleaned, sized and sorted according to color and quality. The company exported both of these products in 60 and 225 liter drums.

On September 13, 1994, the company acquired controlling interest in Olive Branch, a local competitor, owned and operated by the Ganim family. Olive Branch exported olives and capers, and it was acquired to provide ZATON with additional storage and processing room for olives and capers. It retained its own management and product label.

ZATON was the administrative headquarters for these companies The ZATON factory was also the final processing station because it had all of the canned food processing equipment and the pepper roasting line. Both Sunray and Olive Branch would supply ZATON with olives and capers to be packaged in commercial and retail-size containers. The ZATON factory was also the site where green olives were oxidized to become black olives.

Over the previous two years, ZATON had invested over $2 million in new and used equipment to upgrade its facilities. This expansion had cost more than just money for the company. One of the major costs of expansion could be seen in Abdul's loss of control over day-to-day operations. He openly admitted that things were confused at the factory, but that he could live with the disorganization as long as quality remained high.

Another problem was typical of family-run businesses, in Morocco and elsewhere. It was extremely difficult for senior management to delegate meaningful levels of responsibility to subordinates. At ZATON, the overwhelming majority of decisions were made by Abdul alone. He served as managing director and chief sales representative for the company. He had his hand in about everything the factory did. With the expansion, the additional stress and pressure was taking its toll on Abdul's health. As problems at the factory increased, his upper left-hand desk drawer began to look like a pharmacy.

Delegation of responsibility at ZATON was tightly controlled, even among family members. Karim was primarily responsible for all new construction projects as well as accounting. When one of Abdul's sisters came to work at the factory, he had to assert his authority over her a number of times. When she went into the production area and decided to make a few changes, Abdul bluntly informed her that "even though you may be a partner in this business, you don't make decisions. 'If you see something that needs to be changed, tell me, and I will decide.'

Product Lines

ZATON was historically an export-oriented firm. Abdul prided himself in his ability to utilize business trips to find new markets for ZATON produce. This was one of the reasons ZATON was involved in so many joint ventures. Abdul felt that there were a lot of opportunities to make a great deal of money in Morocco. He said that all it took was someone to travel and see what was out there, then come back to Morocco and make it cheaper here. ZATON currently had three major product lines and several smaller ones.

OLIVES

Olives were the mainstay of ZATON's operation. They accounted for the greatest portion of its sales. One benefit of this product over others was its low labor intensity. The olives were for the most part much more durable than any of the other products, and required

Exhibit 2

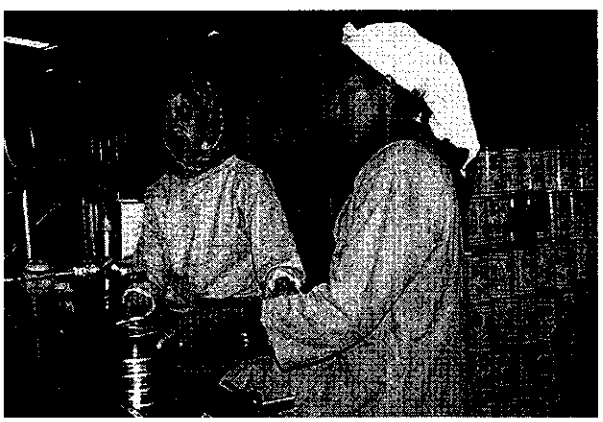
OLIVES PROCESSING

Drawing olives from storage vat for sorting

Sorting olives to remove twigs and damaged ones

Moving damaged olives for shipment to an olive oil plant

Sorting sliced black olives



Stamping tin cans with identification codes

Hand-packing sliced black olives

Topping off drums of olives with brine

much less handling. Most if not all of the handling could be automated. ZATON's main difficulty was that it faced an extremely competitive world market. ZATON had competitors not only in Morocco but also in other countries, notably Spain, the world's leading producer of olives.

Morocco's variety of olive, the picholine, was sometimes viewed less favorably than the Spanish variety. Spanish producers had recently invested heavily in the technical aspects of harvesting and producing to keep their output levels high. Spanish companies also had unfettered access to the European Union, making competition quite fierce.

ZATON was in the process of expanding its market into North America. It had been successful in landing several large orders for black olives from Canada, but was unable to sell them in the United States due to stringent FDA requirements. The factory had taken all steps necessary to comply with these regulations, but their official forms had not yet been approved. With respect to green olives, the company was successful in getting contracts in both the United States and Canada.

The company sold olives in both retail and commercial size packaging as well as bulk drums (60 and 225 liters). In gross sales, the company ranked approximately fifth in size in Morocco, though no accurate market studies had ever been conducted to-date.

It was expected that this year's drought would have a significant impact on next year's crop because olive trees required a mild and damp winter to generate a bountiful fruit crop.

CAPERS

Capers were the second largest product line for the company. Like olives, ZATON sold capers in both retail size bottles and bulk drums. Capers—though profitable—were highly labor intensive when sold in retail size jars. One 20 foot container of 106 ml. jars contained over 96,000 hand-inspected and hand-packed bottles.

ZATON was the leading producer of capers in Morocco. Its Sunray facility processed over 1,200 tons worth of the product in 1994, and with the startup of a joint venture in Turkey, the company hoped to add an additional 1,000 tons of capacity.

By June 1994, the company began to feel the effects of the previous winter's drought. In regions that normally supplied ZATON with 10 tons of capers a day, the company was lucky to receive even one. Prices of raw capers soared in Morocco. Luckily for ZATON, Spain also had a shortage.

Once again, Spain provided the strongest competition for ZATON, followed closely by Turkey. ZATON saw definite advantages to starting a joint venture in Turkey. Not only would they be able to take advantage of lower Turkish wages; they also gained access to a more highly valued variety of the product. The percentage of non-pareil-sized capers was greater in Turkey than in Morocco. Typically the price earned on capers was determined by their size: the smaller the size, the more expensive. In Morocco, small caliber capers only accounted for 5 to 10 percent of the crop, whereas in Turkey, 20 to 25 percent of produce could usually be sold as nonpareille or surfine.

ZATON was fully committed to this venture. The operation was scheduled to start in the beginning of May 1995, and the first year's production was tentatively scheduled to be completed that summer. This was to be only a seasonal operation, and oversight of the first season's production was given to the American FMDAP adviser. In the meantime, the venture's other partners would make use of the factory space in Turkey for additional projects unrelated to ZATON.

Concerns were raised in late March when Turkey, in an attempt to deal decisively with Kurdish rebels, launched the largest military operation in the Republic's history along the southeastern border with Iraq. The joint venture program nonetheless went ahead as scheduled.

PEPPERS

Peppers represented a lucrative market for ZATON in the United States. In 1994, the company had planted 25 hectares, and easily received orders in excess of the projected yield from this planting. For 1995, the company increased its planting to 125 Ha, but the limiting factor was the age and the speed of the equipment at the factory for processing. Roasted peppers were even more labor intensive for ZATON than capers. After roasting, each pepper had to be hand-washed, sliced and packed. ZATON was the only company in Morocco that offered this product line. Photos showing the stages of pepper processing appear below on page 111.

Drought conditions were not expected to hurt ZATON because all pepper planting had been contracted out to farmers with irrigated farmlands. ZATON's problems with raw materials stemmed from the gap between the signed contracts selling 100 tons of raw peppers and the receipt of only 20 or 30 tons from their farmers. It is believed that farmers took produce contractually sold to ZATON and sold it on the open market.

ADDITIONAL PRODUCTS

Other products produced by ZATON were sun-dried tomatoes, apricots, wild onions, and garlic. The only product line that ZATON actively looked to expand was the sun-dried tomato market. Here the company had an excellent opportunity to enter the U.S. market, but once again FDA regulations were making this difficult.

Apricots had proven troublesome because the markets were primarily in France, Belgium and the Netherlands. Abdul had basically stopped production of this fruit because of the pricing techniques typically used by the French. In the past, French buyers would delay placing orders until the last possible minute. They waited to see what final market price would likely be for apricots in France, then purchased them at cheaper end-of-season rates.

Wild onions and garlic were primarily used for local consumption and for company products that required packing in brine. For example, the company began its first production run of artichokes at the end of March. If this test proved successful, ZATON would use the garlic and onions along with other spices to pack marinated artichoke hearts.

An American Executive Advises the Company

In addition to the American FMDAP adviser (an American MBA student working inside the company for a ten month period), ZATON had an affiliation with the in-country office of the U.S.-based International Executive Service Corps. This organization worked in close association with the U.S. Agency for International Development to provide Moroccan businesses with various types of assistance. Through this service, ZATON arranged to have an experienced U.S. food industry executive, Tom Anderson, volunteer to consult with the factory at the end of 1994.

Tom was technically very qualified in all areas of food production. He arrived at the plant and immediately started work doing capacity studies, flow charts and everything needed to evaluate the company. Tom quickly examined the situation and then began assessing the company's food processing quality control and safety features. As important as these efforts were, they were not what Abdul had in mind for this distinguished experienced visitor. He had assigned a trained biologist to monitor quality control and safety activities, and she was in the process of attending the necessary seminars to become licensed in these areas. What Abdul wanted from Tom were ways to improve productivity and increase profits.

Tom's final report was full of flow charts and recommendations. Abdul listened attentively to the briefing and thanked Tom for his assistance, but as soon as Tom left, the company continued on, business as usual.

Tom had even proposed an organizational chart for the company, but he felt that trying to sort out responsibilities and determine who holds them was as confusing to him as the language. In the end, he proposed an organization chart that by Western standards was appropriate and logical. It had Abdul at the top of the organization, reporting to him were different mid-level managers responsible for overseeing production by product line. Each person had defined responsibilities, and each was empowered to make the decisions necessary to run his or her department.

In many ways Abdul was unusual for someone from this region in being so open with his advisers. Often in the Arab world, information is tightly guarded, to the point that people who need to make decisions often cannot do so because they cannot obtain necessary information. It is said that Arab businesses are limited in size by the number of brothers, sisters and cousins in the family. For Abdul to take in someone from outside his family and put them into a key decision-making position, as suggested by Tom's organization chart, was very difficult for him. Decisions had always been made by him or his brother.

Tom's advice to ZATON, though relevant, did not receive the appropriate attention because he was not able to tailor it to the cultural-milieu of ZATON. Tom constantly made statements like "This is how we did it at Del Monte" or "In an American plant, we set things up like this..." Not adapting to cross-cultural differences in his recommendations made it difficult for him to sell his ideas. It was not until months later that Abdul took another look at the report, but by then he was struggling with other problems.

ZATON had been run as a family business since its founding. Making the transition to a mid-size company would require many of the changes Tom recommended, but by not understanding their relevance, Abdul could only see them as threats to his authority and control.

Personnel Turnover

ZATON was also experiencing severe employee turnover. For the most part, the loss of unskilled workers could be corrected with little effort, for new workers could be found and trained almost immediately. ZATON's problems rested with their middle management and skilled employees, where the owners' traditional approach to management caused considerable frustration.

Over a four-month period, the company lost four key individuals. First to go was the factory foreman, Ahmed. Two months later two of the company's accountants left. Two months after that Mahmoud, the manager of Olive Branch, accepted an offer from Producto to construct and run a factory in Fés. Producto was ZATON's largest Spanish competitor. ZATON and Producto had in fact recently looked into the possibility of forming a joint venture, but in the end Producto decided to go it alone—putting a former ZATON manager in charge.

In all cases, money was a concern. For the accountants and Ahmed, money was the deciding factor. For Mahmoud, it was only part of the appeal. His family had opened Olive Branch the same year Abdul's father started ZATON. When ZATON acquired controlling interest in his company, Mahmoud's father, Mr. Ganim, became assistant director of ZATON. Mahmoud was the new director of Olive Branch, but he felt his job was unfulfilling. He said that before the takeover he was in a more junior position, but with more responsibility. He would deal with clients and get involved in all aspects of the business. Now with ZATON as the administrative head, he was left as a middle man with little or no say in the running of the business. His parting words were: "In this organization, when you control only 49 percent, all you can say is 'yes.'"

The loss of the ZATON plant manager was no shock to Abdul. He and Ahmed had been at an impasse over several issues, the most important being compensation. Abdul felt that he could get by without Ahmed because he knew the machines and the products as well as anyone. It took several months for him to realize the importance of having someone in that position day-in and day-out, but finding someone with suitable experience was difficult.

Ahmed quickly found work outside ZATON working for a distributor of canned food machinery. Commenting on his reasons for leaving, Ahmed noted that at ZATON

> I was in charge of everything: maintenance, production, employees, inventory, training, quality control, and whatever else you could think of. With all that responsibility I was making 4,500 Dh a month. I have over 23 years worth of work experience. I asked him for a raise so that I could pay doctor bills for my pregnant wife. I needed a car so I could get back and forth to work. He wouldn't budge at all. Finally, I said that this was enough, so at 7:00 am on October 1st, I walked into his office and said 'Bonjour Mr. Maleh, and Au revoir.' Now I'm using all of my experiences selling the same types of machines that I spent so much time working with. I'm earning 10 times what I earned at ZATON and I'm a whole lot happier. I ask you, after I left, what condition did the machines end up in, better or worse? I think we know the answer to that one.

Overall, individuals in middle-level management positions working at ZATON were becoming more and more dissatisfied with their jobs. As they saw the day-to-day situation become more chaotic, they found no one would listen to them when they had something to report. Many felt the company was going to fail within the next couple of years if things did not change. In general, the consensus was that ZATON was doing too many things, and none of them properly.

The number of workers at ZATON and the other two plants varied according to the time of year and the harvest at hand. Typically, ZATON had approximately 75 full-time employees, with the majority of them poorly educated and unskilled individuals. Olive Branch and Sunray regularly employed 100 workers, and that number usually doubled during harvest time.

ZATON needed the employees with the highest skill level. At Olive Branch and Sunray, if an error was found, it was usually corrected by reinspecting the product. At ZATON, which served as the final production station, errors were usually incorrigible and very costly. For example, one time a steam valve was opened while a full load of olives was being sterilized. The resulting drop in pressure left high temperature liquid in the cans which ruptured most of the seams. The entire cycle of 600 3-kilogram cans of olives was lost. This represented approximately a $4,000 loss.

ZATON's Labor Force

Illiteracy and poor education posed challenges for Morocco as the country worked to improve the quality of life of everyone through industrialization. At ZATON, these hindrances could be seen in attempts to update and automate the factory. The majority of employees at ZATON had little to no formal education. For the most part, women were hired as laborers, and men were supervisors and equipment operators.

For ZATON, as well as many other companies in the Fés area, it was common to see large groups of women crowding around the gates to the factory looking for work. Normally Mohamed, the company's personnel director, would look at the number of regular personnel he had available for the day, and if more unskilled workers were needed, he would have the guard open the front gate and he would select the people he needed. At times the women were so crowded against the gate's door that full-time workers had difficulty working their way through the crowd.

Many times companies would decide they needed people to work an hour or two. There was never any difficulty finding someone. These women acted as a sort of migrating herd, seeking employment opportunities wherever they could be found. When harvest seasons came they were found predominantly outside the processing factories. As work developed in other industries, they would circulate to other companies in search of work.

Most processes were repetitive and required little training. Typical tasks involved sorting and inspecting olives and capers, and loading and unloading cans. When new employees started working or new products were

launched, it was imperative that each person's work be checked to ensure quality. In one instance, when women were labeling jars of capers for a German customer, the women, not knowing the language, placed the labels on upside down.

Even something as simple as signing one's name to acknowledge receiving one's pay had to be handled differently at ZATON. Most payments were in cash because the majority could not read or write (even in Arabic). Even fewer had bank accounts. To record salary payment, the company had employees put fingerprints in numbered boxes on a control sheet.

For the most part, ZATON took good care of its employees. When full-time workers needed extra money, they knew they could go to Abdul and get an advance. Afterwards a portion of their pay would be deducted each week until the amount was repaid.

With unskilled workers, there were problems. The minimum wage of six dirhams per hour was not followed. Daily workers at ZATON were paid a flat rate of 28 dirhams per day. But work started at 7:30 a.m., went to 12:30 p.m., and followed by a one-hour lunch, resumed at 1:30 p.m. and continued until 5:30 p.m.—which was really a nine-hour day. When work fell behind schedule, the women would work additional hours. Whenever they did, they were paid time and a quarter, the rate specified by law. Simple arithmetic (28 dirhams / 9 hours) showed that the women earned only approximately 3.1 Dh per hour.

Majda was the ZATON employee responsible for paying the women. When questioned about the number of hours they were paid, she answered "a half day is four hours and a whole day is eight hours." Even when she was shown the number of hours (9) these women actually worked each day, she stuck with her response adding only that the matter was "not her affair."

Full-time employees received closer to the minimum wage, and in some instances earned more. As noted above, Majda was in charge of the information systems. She created a program to automate the pay procedures, and it mirrored exactly the manual system. For both the manual system and the computerized system, a half day was considered four hours, and a whole day eight hours. After she wrote the program, she was asked what ZATON paid its workers. She immediately responded "Oh, we pay the minimum wage." When informed that the minimum wage was six dirhams an hour, and that ZATON was only paying 3.1 per hour, she quickly said that that payout was only for the daily employees.

Any attempt to install modern equipment was considered impractical because of the amount of employee training required. ZATON was in a financial position to automate a greater portion of its production line. This, however, was not considered feasible because the company would have had difficulty finding an educated workforce capable of running the equipment. The lack of a formally trained maintenance staff was also a major concern.

Since much of the equipment was purchased used, all warranties, maintenance manuals, and equipment publications were in short supply. When adjustments were needed, they were usually done on a hit-or-miss basis. Machinery was adjusted until it "looked good." The lack of a trained maintenance staff also came to light during repairs. Though by local standards these mechanics were trained, in actuality many of their repairs were at best temporary fixes made by substituting a wrong part or bypassing control or safety circuits.

The situation was not much better for those with advanced education. In Morocco the state provided free college education for those who qualified academically. In many instances Moroccans facing no prospects for work continued on as students for years earning degree after degree. Those who tried to find work faced a challenge. If they found work, it was usually positions unrelated to their field or temporary jobs. For the majority, the lack of any type of real work experience was common, as was jumping from job to job.

ZATON faced this kind of labor market when trying to hire a replacement for the factory foreman. The foreman had left the company in the middle of the pepper production run, frustrated over several issues. Tom, ZATON's volunteer American executive, participated in the search for a new plant foreman by interviewing job candidates. Each candidate was a college graduate who had completed school several years before and had since jumped from job to job. Each felt he could contribute to the company, but they would have to complete their education at the company since none had any experience supervising large numbers of people or managing production.

ZATON's Markets

ZATON, in its expansion, had aggressively pursued markets in the United States and Canada, and this was yielding desired results. Orders for roasted peppers, green olives and capers had flooded into the office in 1994. But a major problem the company faced in dealing with the North American market was the language barrier.

The company first began exporting roasted peppers to the U.S. in 1993. This had come about through ZATON's

participation in the Fancy Foods Show in Chicago. After arranging several contracts, the company successfully exported a limited number of containers to the United States.

ZATON was a newcomer to the North American market and when the opportunity came to enter full steam into the fire-roasted pepper field, the company jumped at the chance. Through the services of Joe Conrad, a sales agent in New York, the company quickly received contracts for more than 50,000 cases of peppers. This roughly translated into approximately thirty 20-foot cargo containers to be delivered in an eight-week period beginning in September and ending in October. Contracts had also been written with other individual companies in the United States and Europe.

The Operations Challenge: Filling the Orders

From the beginning Abdul assured Joe that ZATON would have the necessary production capacity to meet the contract obligation. Problems began to surface in the beginning of September when the necessary labels and cartons did not arrive on time. Unlike most companies its size in the United States, ZATON did not have a purchasing department. In most cases Abdul or his brother would order whatever was needed for the company. With the expansion of the company, the brothers found that they had to begin delegating some of their responsibilities to the staff.

This was just the second year that the company sold peppers to the United States, and with a large number of new clients, much preparation was required. For example, each client needed printed labels and cartons that presented their distinctive product information. This normally was not a problem because the customer usually provided ZATON with a set of film negatives used to print the labels. However, the U.S. Food and Drug Administration had recently begun requiring that all products carry nutritional information on the label. This was something completely foreign to the company; it required that each label be redesigned with the appropriate nutritional information added.

After some delays, proofs for all redesigned labels were approved by their respective companies. It was then time for printing, but ZATON learned that the printer was short on paper and it would take at least a week before paper supplies could arrive from Spain.

Meanwhile production continued and valuable factory floor space was occupied by an increasing number of orders awaiting labels. When the labels finally arrived, management was alarmed to find out that Fatima had not ordered the cartons. Fatima, one of Abdul's sisters, had joined the company at the end of the summer after leaving her job as a technician for a firm in the capital city of Rabat. She had no formal business experience as a manager, but her job was to help create the necessary management information systems for the company. The company had recently purchased a computer but this was underutilized.

Fatima involved herself with the day-to-day operations of the factory and had little time for writing needed programs. In her first six months with the company she wrote only one program, which supported payroll. When she finally started programming in earnest, her software addressed what she perceived to be the needs of the company but she failed to consult people who would use the information. As a consequence, she spent much of her time writing programs that did not fit the needs of the company.

Not ordering cartons was just one consequence of inadequate communication inside the corporation. Many other examples could be found. The same was true for external communication. An almost continuous flow of faxes poured into the office on a daily basis from customers and agents wanting to know the status of their orders. For the most part the faxes sat in piles on Abdul's desk awaiting his response.

The greatest delays usually occurred with English-speaking clients. Even though Abdul's English was good enough to conduct business face-to-face, he still had problems when it came to writing. With simple faxes, he was able to muddle his way through and give a coherent response, but when it came to long faxes and technical jargon, he would often be overwhelmed and call in his FMDAP adviser for help.

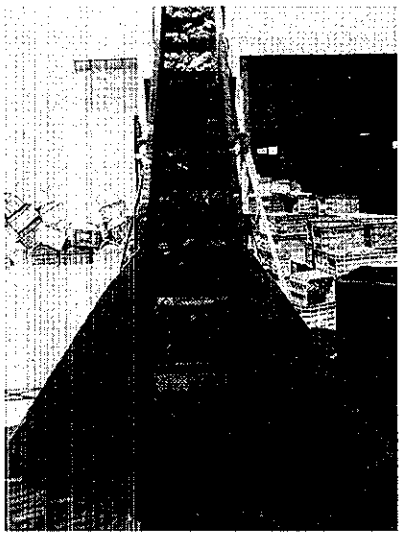
If these were the only delays the company experienced, there would have been no problem meeting the October-end deadline, but these were just the tip of the iceberg. Problem after problem beset the company in its efforts to get the product to port for shipment to the United States.

The company used a single rotating pepper roaster that was purchased used. The peppers were loaded onto a conveyor belt which raised them approximately 20 feet and deposited them into a 5-foot-wide rotating tube that was angled down at about 5 degrees. At the opposite end of the tube was an industrial gas burner that sent a flame into the tube. As the tube rotated, the peppers would cascade through and the flame would roast and completely blacken the peppers. The peppers would then tumble into a cage where they were washed to cool them and wash away a large part of the blackened portion. From there the peppers would go to a conveyor belt where women would core and de-stem them. The next step in the process was another caged bath that brought the peppers to the slicing and filling station.

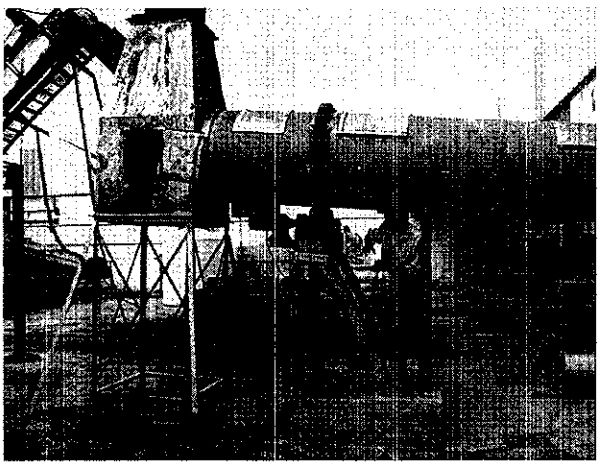
Exhibit 3

PEPPERS PROCESSING

Harvesting peppers

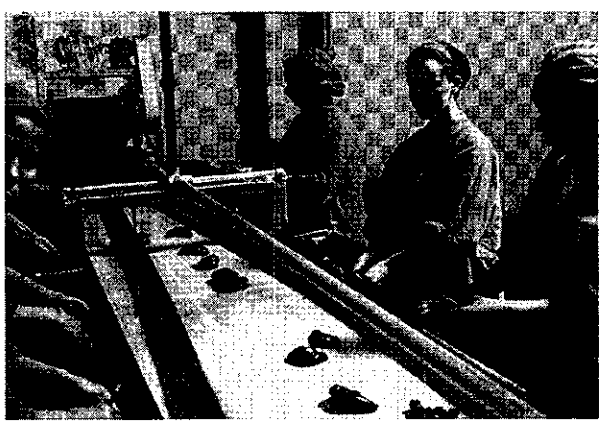


Peppers entering the roaster via a conveyor belt



Making repairs to the roasting tube

Peppers tumbling down roaster tube into bath for washing



Slicing peppers

Bottling peppers and weighing for accuracy

Once the peppers were in jars or cans, they were weighed to ensure the proper amount was inside. The next step added acidic brine to the peppers, and the can was then sealed by the closing machine. After pasteurization the product was ready to be labeled, cased and shipped.

During one time or another, ZATON had problems with each section of the line. Most problems involved the two most critical pieces of equipment: the roasting tube, and the can closing machines. At the end of October, the roasting tube shattered a support bearing. This shut down the line for half-a-day while a new bearing was bought and installed.

The bearing held the tube, keeping it from shifting downward from its original position tilted at a 15 degree angle. The bearing was aided by supports on each of the four rollers that spun the tube. Initially the shattered bearing was considered a minor problem, but two days later, the replacement bearing shattered. Something was causing the tube to exert more downward pressure than normal. A number of ideas were considered, but the company was under such pressure to continue producing peppers that it decided just to replace the bearing and fix the problem later.

Unfortunately, the time between shattered bearings dropped. It went from two days to a few hours. Each time a bearing shattered, the line would be down for a minimum of an hour. Finally, after replacing the bearing for the third time on a single day, Abdul called it quits. He said that until the problem was solved, the roaster could not be used.

Various attempts at keeping the tube from sliding were unsuccessful, and the delays created by the machine being down were increasing. The majority of the daily workers had been laid off, and work for the remaining full-time employees was limited. Eventually management believed they solved the problem by encasing the support legs in concrete to limit the amount of vibration caused by the one-ton tube. This solution was never fully tested, however, as it was implemented at the end of the season.

Finally, as mentioned above, when it rains it pours. Morocco experienced several days of intense rain at the end of October that ended up flooding a large portion of the country. Though there was no flooding in Fés and the local area, a large number of crops were damaged by the intense rain. ZATON had to become much more selective regarding what peppers it accepted to screen out poor quality produce. The rains came at the end of the growing season, and they prematurely ended it.

ZATON now faced the fact that it had promised 30 containers of peppers to Conrad's clients alone but had only shipped six. The company had to default on 80% of its contracts with its New York agent. It had not even yet begun to fill its other independently signed contracts.

Also of concern to the company was the presence of prepared lithographic tins requested by one of its customers. These tins were more expensive, but they provided a much nicer looking product because all the label information was printed directly on the can. This reduced one of the handling steps for ZATON, while at the same time improving the appearance of the product. But ZATON was now stuck with 80,000 of these tins that could only be used for this client. The company also had several thousand company specific cartons.

An American Sales Agent Visits the Factory

Joe Conrad of Conrad Imports, Inc. finally came to Morocco on a business trip to examine the quality of the peppers being exported and to find out why his shipments were so far behind schedule. He faced several problems on this visit. One was his extremely tight schedule, and the other was his inability to speak either French or Arabic.

"You must put the nutritional information on the label now; the FDA requires it. Here, look at the Roland label, it's the same product, so the information is the same. You just have to reformat it and add it to the Dara Brand label."

"Yes, yes, no problem."

"For two hours you have been saying 'yes, yes, no problem,' but I think we still have problems. I don't have a lot of time because I have to be in Casablanca by four this afternoon, and we have to get this worked out. You just don't understand what I am saying."

Joe said that he had talked with Abdul over the phone on many occasions until he was blue in the face. He always got the answer "no problem" but there were always problems. He did not understand that in order for Abdul to understand him, he had to speak slowly. Unfortunately the more frustrated Joe became, the quicker he spoke. Joe's strong New York accent only added to the communication gap.

Abdul and Joe were equally frustrated and the meeting was going nowhere. Joe had a definite problem understanding the cultural patterns of Morocco. Abdul decided to bring the FMDAP adviser in to their meeting to let him make sense of the problems under discussion. When they finally got down to discussing product labels, and the new regulations for including nutritional information, Joe did not want to deal with Abdul at all. He had discussed the matter for two hours over the

telephone and Abdul still did not understand. The adviser took Joe into another room enabling Abdul to make a break for it, which he gladly did.

Joe came from a world where customers screamed to get results, but screaming in New York did not instill a sense of urgency in Morocco. Joe was also upset that Abdul had accepted an order from another company, Leslie Foods International, and he planned to ship them their goods before he filled existing orders. Joe believed that Leslie had not committed to a contract in the beginning because he did not like the price, but now that no one else had peppers, he was coming to ZATON.

Abdul had accepted and made the Leslie order a top priority for one very simple reason, one not commonly heard in U.S. business circles: George Leslie was his friend. They had met during a food exposition in the United States, and he was the first client to whom Abdul had exported. To him that meant a great deal. Giving priority to friends was a common business practice in Morocco.

The adviser told Joe that personal contacts meant a tremendous amount in Morocco. In business, it meant much to be dealing with a large, powerful corporation, but most times your reputation, hospitality, and manners were more important. Urgency and impatience were not appreciated, and usually these traits did more harm than good. They were generally considered rude.

Moroccans respected a low-key approach and typically took longer and consulted more associates in their deliberations than did American businessmen. In many cases one had to deal with several people at the same time and keeping track of things was difficult because people wandered in and out of meetings frequently. In general, business meetings were protracted events that sometimes consumed more time than one had available. The process of negotiations could take hours, but that was an everyday reality.

Joe expressed concerns that ZATON would not be able to make its contract commitment. "He should have shipped at least one container of peppers already to Roland foods. Why is he doing a bottling run? He should be packaging cans now! When am I going to get my product? People (from Cosmo's Foods) are crying out in Connecticut for the canned product, yet he is doing a run of bottled peppers.

"This trip is costing me an awful lot of money. The plane was outrageous because I had to change it at the last minute, and now I have to take a taxi all the way to Casablanca (4 hours away). That's going to cost me an extra $100, but I have to be there by 5:00 because I have a meeting. I just don't have enough time! The problem is, if he can't fill his order, he is going to leave these people high and dry."

The Sales Agent Saga: Two Months Later

The reality of the situation became clear to Joe in the next few months. Commenting to the FMDAP adviser, Joe lamented over the phone from New York:

> "I'm looking at a disaster here. You mean to tell me that there is no product left to be shipped? For months now he has told me that there was no problem, and that they would ship everything. Now he's telling me that there's nothing else coming this year? I mean I would have been happy if he had shipped half of it, but we didn't even make that. You only shipped six of the 30 containers you had orders for. He never should have sold to Leslie. We had longer standing contracts with others who now aren't going to get any product. Thanks for the faxes though. I have had such a hard time getting any information out of him. We're just in such a bad situation here, I just don't know what we're going to do. He has lost a lot of face around here. I don't know why he is going to the show in San Diego. It's a complete waste of time. Nothing is going to go on there. He needs to get his act together. First things first. He needs to get his production going and get some product out. He doesn't need to try to find clients; he needs to get his shop in order. Well, at least we got this much, and when you're gone, communication is going to be impossible."

Joe was thoroughly frustrated. To him it was not ZATON defaulting on contracts, it was Conrad Imports Inc. which let its clients down. Luckily for Joe, he was able to find suppliers in Mexico that still had enough product left to fill his orders. In fact, Joe was even able to come out ahead. In January the Mexican Peso suffered a massive devaluation, and because of the increased buying power of the dollar, Mexico became one of ZATON's newest competitors.

The Next Season

Throughout the winter of 1994, ZATON continued its operations. For the most part olive production went fairly well. ZATON was able to land a large contract for black olives in Canada. Significant problems began to arise in late May with both green and black olives. The company fell increasingly behind in its deliveries to its Canadian client. It also fell short by approximately one million pounds of green olives to its European clients.

Continuing problems between the EC (especially Spain) and Morocco reached the point where Spain was threatening to seize agricultural products shipped from Morocco. ZATON consequently had to delay several contracts to ship to Spanish clients.

During this time the company formally entered into a joint venture with an Italian firm to produce artichokes. ZATON also began a joint venture with a group of Turkish cotton farmers to produce capers. ZATON's role in this venture was to supply the technical assistance and the marketing networks for the product.

Though these ventures served to increase ZATON's markets, they had the negative effect of adding more confusion to an already chaotic situation. Mr. Ganim, the former owner of Olive Branch, was quickly overwhelmed because he was now supervising the production of olives, capers, peppers and artichokes all at the same time.

All of the junior-level managers were complaining that the company was doing too many things and doing none of them properly. Quality control was becoming an even greater problem. One promising note, however, was that Brahim, the company's chief mechanic, attended a week-long course on repairing the can closing machines and the other processing equipment.

A study was undertaken to determine how many contracts the company could sign for peppers for the following season. Based on an estimated yield of 2,000 tons of raw peppers, ZATON was already committed to using 35 percent of this amount to fill last year's contracts. Abdul decided that once last year's contracts had been completed, it would be safer to produce full containers and then sell though his agents.

ZATON began to receive peppers at the end of April, and within the first two days of processing, problems began. The roller bearings began to shatter, and production halted. The company also had to throw away a complete truckload of peppers because they sat too long before processing. Luckily for the company, these peppers were not part of the ZATON crop. They were peppers that were bought on the open market, and the company was under no obligation to buy any others. ZATON's pepper crop was not going to be ready until June. The company had to find a long-lasting solution to this production problem quickly, but the chief maintenance person was too busy fixing all other daily problems to tackle this one.

In the middle of May, the King of Morocco addressed the country saying that the drought had made this year's expected crop yield only one tenth of the previous year's output. He stated that he was attempting to raise $200 million to help those who lived in the country, and that he and the members of the cabinet were going to donate their salaries until the amount was reached. An account was set up at one of the national banks for people to make donations, and all the country's soccer teams agreed to donate their gate receipts from the following weekend.

At the same time, there was a series of nationwide railroad strikes. The railroad was the principal means for transporting not only people but also all merchandise produced inland. ZATON, unable to send its shipments to clients, fell further behind in deliveries. An opposition newspaper claimed that economic impact of the strike was much greater than the actual pay demands of the railway workers.

To make matters worse, the management decided to enlarge their office facilities at the ZATON plant to help them get organized. This involved completely renovating the offices. While Abdul was in Turkey signing the joint venture contracts, his brother Karim, in charge of the office enlargement project, decided that it was going to be too difficult and expensive to renovate the existing building. So he and the rest of the family decided—without Abdul's approval—to demolish the building and rent an apartment to serve as the office in the center of town.

Renting the office was done with such haste that the office was thrown into complete confusion. They demolished the building before the apartment was ready. The company was unable to keep the same telephone numbers, so now customers, clients and suppliers had no idea as to the company's new phone numbers. In the meantime, files, schedules and all other administrative equipment were thrown into cardboard boxes and nothing could be found efficiently. The company even lost a leased laptop computer.

The family kept Abdul in the dark about these changes because they wanted to surprise him. They were very happy to have their new office in a suite in the tallest building in Fés, but they completely overlooked the problems this move caused. Now instead of being just a 30 second walk to the factory, Abdul now had to drive 10 minutes. Supervision was now even more difficult for him, and when asked if he felt the company was organized enough to work like this, Karim replied, "Well, now, we will have to, won't we."

Abdul immediately recognized that this would cause immense problems and told his brother to rebuild the office on the ZATON site. Instead of hiring an architect to design the building however, Karim decided that he was going to design it himself, even though he had no experience in this field. Rebuilding the office was projected to take a minimum of six months, the length of the next pepper season.

APPENDIX

BACKGROUND ON MOROCCO

History of Morocco

The Kingdom of Morocco is the western-most of three North African countries known as Jeziret al-Maghreb or "Island of the West" in the Arab world. Roughly equal to California in size and variability of climate, it is the closest nation in Africa to Europe—separated only by the straits of Gibraltar. The country is bounded on the north by the Mediterranean Sea, on the west by the Atlantic Ocean, on the south by Mauritania, and on the east by Algeria.

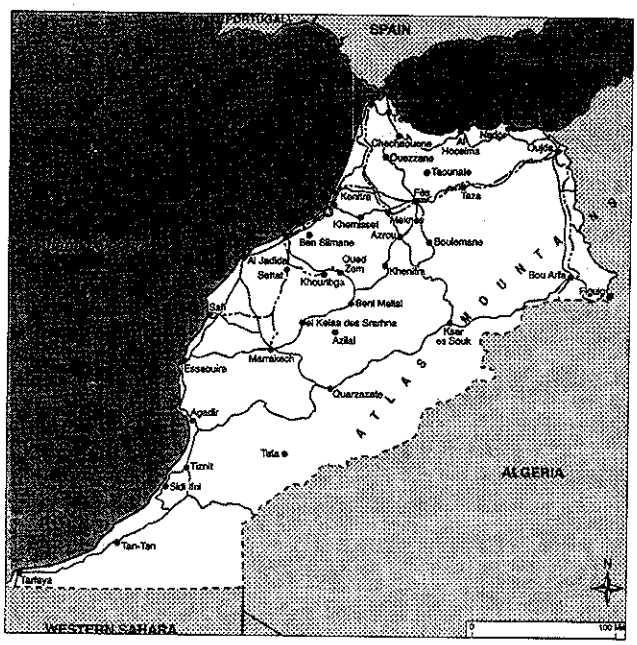
Often labeled as "a cold country with a hot sun," Morocco has a climate as varied as the landscape. The country is dominated by two mountain ranges. In the north, the Rif mountains rise almost directly from the sea. Running north to south are the Middle and High Atlas mountains, rising to over 13,000 feet, forming the backbone of the country. The coastal plains of the country are supported by a mild, semitropical climate. This plain, known as the Gharb, is usually adequately supplied by rainfall to support the country's agricultural industry. It is here that the majority of the country's large cities and population is located.

The area to the south and east of the mountains is largely arid and sparsely inhabited, much of it part of the Sahara Desert. The population in these areas is concentrated on the oases along the Draa and Sous rivers.

Morocco is a unique nation. Arriving in the country at any major city, one finds a distinctly European atmosphere due in large measure to the influence of French and Spanish colonialists. Once outside these cities, however, commerce retains features of earlier centuries. Business is conducted in the many different souks or markets, just as it was in medieval times.

Exhibit 4

MAP OF MOROCCO



Fés

Fés, Morocco's third largest city and one of the nation's four Imperial cities, is considered the cultural and religious capital. Students from around the world study law and theology at the 1,000-year-old Karaouine University and mosque.

Originally founded in the eighth century, the traditional way of life in the medina has remained relatively unchanged since its beginnings. The French designated the old city a historic landmark, and as such, changes and modernization have left the old city relatively untouched. Roads and alleys are laid out in a fashion that give it a striking resemblance to the mythical labyrinth of ancient Greece.

The French built a new city after World War I two miles away, and this has become the industrial and administrative center of the region. The city's estimated population of just over one million is split equally between old and new Fés.

The country gained its independence from France in 1957 after more than 40 years as a colony. The French had a profound impact on the culture. Most business today is still conducted in French, even though the official language is Arabic, and French food and culture are found everywhere, down to the petit taxis and sidewalk cafes.

Morocco is a constitutional monarchy, with the king serving as head of state and spiritual leader. King Hassan II has ruled Morocco since 1961. He is part of the Alaouite dynasty that has ruled Morocco since the 17th century, and which traces its ancestry back to the prophet Mohamed. He is the latest in his family's line to bear the title "Commander of the Faithful."

The country's official religion is Islam, but Moroccans are relatively tolerant of other religions. The majority of Morocco's Moslem population is Sunni, and the king has been effective at keeping the Islamic fundamentalist movement under control. Neighboring countries have not been so successful, and these forces there have proven to be a destabilizing factor in society.

The Economy

Over the past decade Morocco has become increasingly urbanized and industrialized. Immigration flowing into the large cities has only aggravated Morocco's large unemployment problem. Despite increased industrialization, however, agriculture remains the most important segment of the economy, employing over half the workforce.

Cash crops, including citrus fruits and vegetables, have benefited most from state incentives and inducements. These have been felt upstream—through the financing of equipment for irrigation systems, the distribution of subsidies and the provision of inputs and intermediate goods, and downstream in the economic system—through the organization of marketing channels, mainly for exporting.

In 1993 exports for this sector accounted for 25 percent of the nation's total, which was equivalent to 15-20 percent of GDP. The main exports of the country included phosphates (Morocco has one of the world's largest reserves), phosphoric acid, citrus fruits, textiles, fertilizers, fish and canned vegetables.

Agriculture

Crop yields depend on the timing and the magnitude of rainfall, or in other words, when the rains come and how heavily they fall. Unfortunately for ZATON and the rest of Morocco, rainfall from the end of 1994 through the summer of 1995 was not helpful to the country. At the end of October, severe rains flooded portions of the region. In areas where rainfall was less extreme, there was still severe damage to a large portion of the crops.

Normally winter rains are the source of life for many crops. Throughout the fall and winter, with the exception of the October rains, this year the country experienced a severe drought. In many areas of the country, talk centered around the need for rain and how bad the year would be if no rains came.

On January 20th, King Hassan II, the country's monarch and spiritual leader, led a noontime prayer session with a special prayer for rain. Some rain in fact fell that day, and devout citizens thanked Allah and the king.

Literacy and Labor Practices

By official estimates the literacy rate was somewhere around 45% for males and 22% for females. This figure varied by geographic region. In the more urbanized areas a significantly greater percentage attended school, while the opposite was true in rural areas. An estimated 85% of boys and 53% of girls attended primary school for at least some period. This figure dropped to 35% and 22% respectively for secondary schooling. Both primary and secondary schooling were patterned after the French system, with instruction given in both French and Arabic.

The availability of unskilled labor posed no problems in Morocco. Official estimates of unemployment reached as high as 20 percent, and the number of Moroccans in under-employment situations—those having fewer than 40 hours of work per week—was equal to or greater than that. Overall it was a discouraging situation for those seeking employment.

Life for an unskilled worker usually meant less than the minimum wage, and in Morocco that translated into approximately 54 cents an hour. Depending on the source, per capita income in Morocco was between $550 and $900 per year.[2]

Often owners of factories complained that their margins were too low, and that they could not afford to pay the minimum wage. This may have been true on the books, but this was because much of the money was immediately diverted to other projects, or else used to pay off family bills for new cars, villas and travel expenses.

Morocco had very modern legal codes designed to protect the rights of the individual, but some observers felt they were mostly a whitewash for the international community and were usually not enforced. Many international aid packages were now being tied to assurances that wages and proper working conditions were enforced, so that more than just management and ownership would benefit. The minimum hourly legal wage was DH6.00 for a maximum of 48 hours per week. Many Moroccans not only exceeded that number of hours per week, but also were paid less than the minimum wage.

In Morocco the work contract between the employer and the employee was based on the Royal Decree of August 13, 1913 which defined the rights and responsibilities of each. The contract could be oral or written, and every worker had the right to a weekly day of rest of 24 hours and the 11 statutory paid holidays. This was variable because an employer could petition to have lost work days made up if there were a shortage of raw materials, damaged machinery or seasonal lows.

There was no specific law that forbade employee discrimination in Morocco, but the Moroccan Constitution stated that everybody was equal before the law irrespective of sex or religion. Being fired from a job could take place for any number of reasons, including incapacity due to age. Officially the minimum legal age to work was 18, but in practice this was not followed. Many children were kept from going to school so that they could work in family-run businesses or any other job to contribute to family income.

It was common to see little children working not only in family-run shops and stores, but also in major factories, especially the textile and carpet mills. Here, when dealing with artisans, a different set of laws applied. In many instances mothers brought their children to work with them. The owners of these factories made a contract with the mother to pay the wages of the children. In effect they were not paying the children, but rather the mother. It was just a technicality that allowed the use of child labor.

Other examples of different labor practices included women working in the textile mills unpaid for their first few months. The owners of these factories informed the women that they were "in training" and as such did not qualify for pay. These women worked 9 or 10-hour days sewing pockets or other minor parts of the pattern for several months without pay. In many instances, if the company fell behind in production, management would not even allow the women to take breaks. There was no set schedule for the completion of training, and if management did not feel like hiring anyone, they could let these women go.

Discussion Topics

1. In order to establish Western management practices in a company in the developing world, management must consider how to adapt those practices to local society and organizational culture. Given the prerequisites for successful adoption of management philosophies like Total Quality Management (customer-driven quality, top down management commitment, continuous improvement, measurement and reporting systems to manage by fact, and ongoing training of the workforce), and given the cultural, political and historical context of firms in the developing world, how can companies such as ZATON bring about needed change?

2. As more and more "developing nations" enter the global market, expatriates who work there experience many difficulties beyond just bridging the language barrier. Consider the reasons for these difficulties. Examine the experiences of Tom Anderson and Joe Conrad and discuss ways to better prepare Western-educated executives and consultants to play a constructive role in the developing world.

3. ZATON is experiencing numerous difficulties across the entire organization. Examine these problems systematically and discuss their interrelationships. Consider among other things how problems in the management structure affect the plant's operation. Be sure to consider cultural milieu, technology transfer, human capital and the macro environment.

4. Ethical issues confront all levels of management. In the ZATON case, fairness of wages is a central theme. Some employment practices observed in Morocco are unacceptable in the United States. These differences raise questions: What are the responsibilities of owners to their employees? What are the responsibilities of managers who are aware of unethical practices in their organization? Should they (a) ignore the problems altogether, (b) risk losing their jobs by bringing these concerns to the attention of senior management and/or governmental agencies, or (c) quit their jobs in protest, possibly speaking out publicly?

NOTES

1. This case was written by Shawn Cochran of the University of Connecticut. It is intended as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

2. An hourly wage of $.54 implies a "full-time" annual salary of ($.54/hr)(8 hrs/day)(250 days/yr) or $1080. Most workers made less.

Business Development Services (A)[1]

Cape Town, South Africa

CASE A. DIVERSITY ISSUES IN THE NEW SOUTH

On the Road to Visit the Provinces

It was seven o'clock in the evening, and the team had been on the road since six that morning. They were all tired after having traveled approximately 800 kilometers across the semi-arid land of South Africa. Along the way, they had stopped to conduct three site visits at organizations that had applied to become Local Business Service Centers (LBSC), small business development centers sponsored by the government to spur entrepreneurship among the nonwhite populations of South Africa.

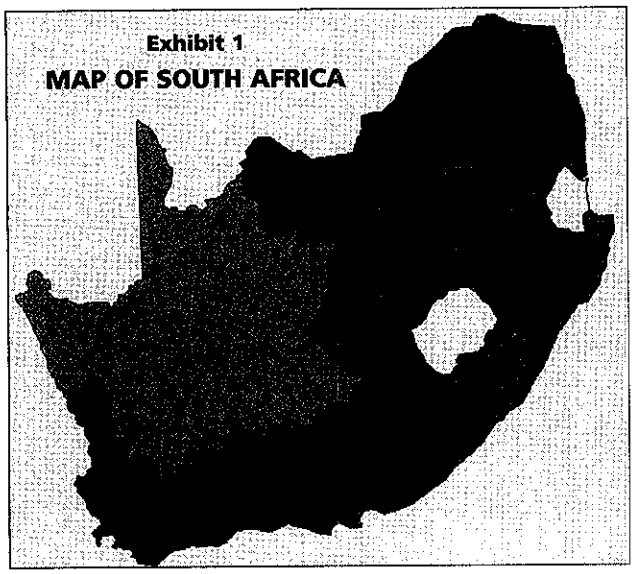
The five travelers were a diverse bunch. Nicole, a white consultant hired by the Ministry of Trade and Industry of South Africa, was brought from the United States to assist with the startup of the first LBSCs in South Africa. Joe was a Cape colored (a South African classification for people of mixed race, either black and white or Indian) from the Western Cape and manager of the LBSC program. Rumi, a Sotho from the Free State Province, was recommended for the group by the Provincial Ministry of Economic Affairs. Mbulelo, a Xhosa from the Eastern Cape, ran his own consulting business in Port Elizabeth. And John, a Cape colored man from the Western Cape, was a politician in the small town of Ceres. Between them they spoke six different languages fluently and were from three different racial backgrounds (Caucasian, South Asian and Negro). Nicole was the only female of the group and the only white member.

Together they made up one of the two national accreditation teams whose job was to evaluate and assess the

Mbulelo, Rumi, John, Nicole, and Joe outside of the Virginia Gold Mine, Virginia, Free State Province

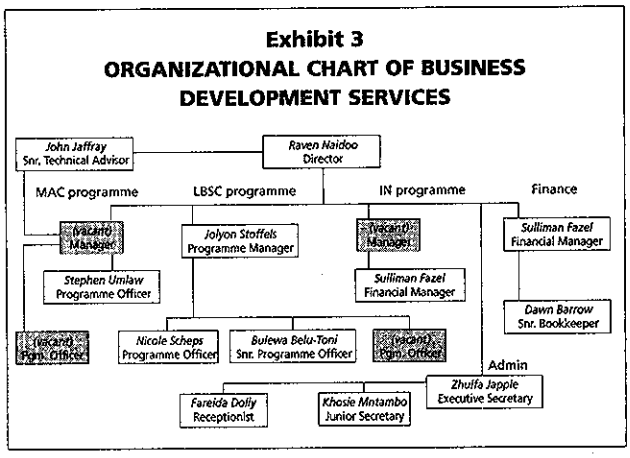
John waiting in the minivan for travel to a site visit in Welkom, Free State Province

Joe speaking with an applicant in their community garden outside Bloemfontein, Free State Province



applicants for Local Business Service Centers and make decisions as to which applicants qualified to be LBSCs.

As they zipped through the beautiful countryside of the North-West and Free State Provinces in their minivan, Nicole was reminded of the Western part of the United States. It was dry and deserted for the most part and her mind was far from the task assigned. The horizon ran as far as the eye could see, and the sun was setting. It was one of the most beautiful sights Nicole had ever seen. Every once in a while, Nicole glanced at John driving, Mbulelo sleeping next to him, Rumi paging through the novel that Nicole had just finished and Joe talking to his wife on his cellular phone. In the short time Nicole had known these men, she had developed an enormous amount of respect for them and the task they were sent to do. She reflected on all the blood and the tears that had been shed on this land and the intense political pressures both domestic and international that ultimately led her to be there on this glorious evening in November 1995.



Finally they reached the small mining town of Welkom in the Afrikaner region of the country. They were all relieved and eager to escape to their hotel rooms. Rumi got out to check them into the hotel. When he returned to the van, he told them the hotel apparently did not have their reservation. A collective groan could be heard from inside the minivan. The others asked Nicole to go see what happened. She followed Rumi into the lobby and walked up to the two smiling white hotel receptionists, and—sure enough—they found their reservation. The mixup could have been a simple mistake. But in South Africa, race issues were at the forefront of everyone's mind, and Joe lashed out in response to this treatment. That moment was their first—but certainly not their last—tense racial encounter.

Nicole realized that the accreditation of the country's LBSCs was not going to be an easy task. It posed significant challenges to both the accrediting team and Business Development Services, the nonprofit organization set up to oversee the centers.

Developing Small Business in South Africa

The Department of Trade and Industry (DTI) of South Africa had recently embarked on a program whose goal was to integrate Small, Micro and Medium-sized Enterprises (SMMEs) into the heart of economic activity in South Africa. Through a White Paper on the development of a National Strategy for the Development and Promotion of Small Business in South Africa, and the subsequent President's Conference on Small Business held in Durban in April 1995, the country crafted a strategy for promoting small business throughout South Africa through the creation of an enabling and supportive network of advisory services. In particular, both the White Paper and the Presidential SMME conference stressed the urgent need for "all would-be and

existing entrepreneurs to have easy access to high quality business support services." Such mechanisms, they emphasized, had to support the following two SMME market segments in particular:

- Viable micro and small enterprises, based on assumptions of sustainability and potential growth, and
- Small (often disadvantaged) manufacturing enterprises that had aspirations and potential for growth but lacked technological and manufacturing expertise.

To meet this need, Business Development Services (BuDS) was created as a nonprofit organization in April 1995, on the understanding that providing access to high quality business support was a key requirement in South Africa's program of economic development.

In meeting its mission, BuDS, through its Cape Town office, launched three programs:

(1) Establishing a network of accredited Local Business Service Centers (LBSCs) whose aim was to respond to the needs of local viable micro and small businesses. Accredited LBSCs would provide the first tier of generic services to SMMEs. Such services included business planning, business information, management advice and counseling, aftercare and networking to other business support services. In addition, the accredited LBSCs were expected to develop other projects and services in response to local needs. In this sense, they were to launch local enterprise partnerships combining the power of local and provincial government with the efforts of business, professional and community organizations, all in support of SMMEs.

(2) Developing a complementary network of Manufacturing Advisory Centers (MACs) to service the needs of small manufacturing enterprises. These centers were to offer sector-specific assistance to small manufacturing firms and enable creation of manufacturing firms in disadvantaged communities.

(3) Building the personnel, institutional and electronic networks through the Information and Networking Programme to link LBSCs and MACs together, sharing their data and information and providing support and networking environment to serve other organizations helping SMMEs.

The role of BuDS was to coordinate activities for this national network of LBSCs and MACs. Their managers and program officers were to keep communications flowing between centers and to sponsor conferences, workshops and information sharing sessions for the accredited LBSCs and MACs.

An LBSC was an accredited organization delivering non-financial business support to small and micro enterprises. The target market of the LBSC was viable and potentially viable micro and small enterprises. It was to be a community-based organization serving the local community. An LBSC was accountable to a board of directors, which ideally was comprised of relevant officers and stakeholders from the local business community. Any organization satisfying the accreditation criteria could apply to become an LBSC. The ten criteria for accreditation follows:

Exhibit 4

ACCREDITATION CRITERIA

1) Strategy, Statement of Purpose and Business Plan

- All accredited LBSCs will be expected to formulate an appropriate strategy supported by a statement of purpose (mission statement) which reflects and responds to local, sectoral, or targeted group needs.
- The statement of purpose will be supported by a 2 year business plan, highlighting the proposed LBSC's objectives, aims and activities. Attention should be given in the business plan to evaluating local needs; identifying and meeting shortfalls in providing service; marketing and evaluating services.
- Although LBSCs may be built on existing or proposed local arrangements, they are intended to be essentially new ways of delivering services to targeted clients. As such the business plan should clearly identify the specific clients of the LBSC, for example by geography, sector, or specifically targeted group.

2) Core Services

All accredited LBSCs will offer the nationally agreed menu of core services but may also provide additional support. The core services of accredited LBSCs will be:

2.1 Counselling

This should preferably take the form of one-on-one contact, and should include a system of client tracking. The method to be used should be shown in the application.

2.2 Basic business management training

Programmes should be responsive to local needs and should state clearly the products offered and the target market, (for example people who have little or no business experience).

Training programmes may include:

- self-employment workshops;
- the introduction of new ideas and opportunities to business-minded people; especially in disadvantaged communities;
- how to prepare a business plan;
- basic bookkeeping;
- marketing
- basic conditions of employment
- commercial and labour law application for SMMEs;

Exhibit 4

ACCREDITATION CRITERIA (continued)

- general business management;
- computers and information systems

2.3 Signposting and referral

The LBSC will also have to demonstrate that it is an active and credible player within the wider SMME environment. LBSCs must also take advantage of the LBSC badge to gain access to the wider LBSC network.

Signposting methods may include:

- a database on new and existing business opportunities;
- information on subcontracting opportunities through business linkages;
- regulatory or statutory issues concerning SMMEs;
- providing or facilitating additional non-core services (see below).

2.4 Experience exchange

Existing or aspirant SMMEs should be put in contact with matching business for the purpose of peer group support and interaction.

This can be done by:

- newsletters (submit copies of previous issues, if any);
- seminars and workshops;
- the formation of clubs, associations and member based organisations.

2.5 Recommended additional services

In line with the overall objective of responding to local needs, the LBSC will probable supplement these core services with a range of additional services

These include:

- vocational skills training
- large company/small company linkages and networking;
- market opportunity registers;
- bulk purchasing opportunities;
- book keeping and financial management support;
- business opportunity database/information.

3) Code of Ethics

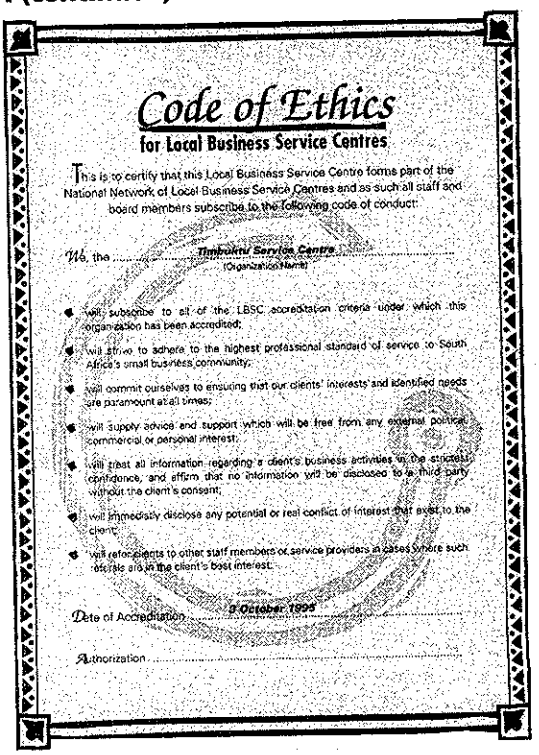
- To ensure the highest professional standard of service to South Africa's existing and aspirant entrepreneurs, all accredited *LBSCs will be expected to subscribe to a professional code of ethics.*

■ *Supplementary notes*

In consultation with all those attending the workshops, BuDS has produced a recommended code of ethics (in the accreditation guidelines) to which **all applicants must subscribe.**

4) Legal Status

- All accredited LBSACs will be structured to ensure financial and operational transparency, and accountability to local stakeholders.
- Applications for accredited LBSC status will be invited from local organisations that have stakeholder representation in a specific business community. For example, private or public sectors, service providers, women's groups, and youth groups.
- The specific legal structure adopted will reflect local and organisational factors, such as, existing service provision, local partnerships or arrangements, etc..
- All accredited LBSCs will be non-profit organisation.



Code of Ethics

for Local Business Service Centres

This is to certify that this Local Business Service Centre forms part of the National Network of Local Business Service Centres and as such all staff and board members subscribe to the following code of conduct:

We, the ..... Timbuktu Service Centre .....
(Organization Name)

- will subscribe to all of the LBSC accreditation criteria under which this organization has been accredited;
- will strive to adhere to the highest professional standard of service to South Africa's small business community;
- will commit ourselves to ensuring that our clients' interests and identified needs are paramount at all times;
- will supply advice and support which will be free from any external political, commercial or personal interest;
- will treat all information regarding a client's business activities as the strictest confidence, and affirm that no information will be disclosed to a third party without the client's consent;
- will immediately disclose any potential or real conflict of interest that exist to the client;
- will refer clients to other staff members or service providers in cases where such referrals are in the client's best interest.

Date of Accreditation ..... 9 October 1999 .....

Authorization .....

5) Statutory Obligations

- As professional service providers, accredited LBSCs will strive towards compliance with all relevant statutory obligations.
- All accredited LBSCs will aspire to good employment practices, and as such, be role models for SMMEs.

6) Charging for Services and Fee Policy

- There is an urgent need for LBSCs to reflect a professional image to ensure a businesslike approach. Accordingly, all accredited LBSCs will be expected to maximise opportunities for cost recovery and move towards sustainability. To this end, LBSCs will need to develop an innovative range of income sources.
- LBSC charging policy must reflect the local conditions and the ability to the target audience to pay whilst maintaining an open door policy.
- LBSC charging policy must be communicated simply and in a fashion which does not alienate potential clients. However, it should also clearly indicate the true cost of the services provided, particularly it the provision is subsidise day external support.

7) Financial Solvency

- All accredited LBSCs will be required to demonstrate financial solvency for a period of at least 12 months following approval.
- Written assurances relating to solvency will be required before LBSC accreditation is granted.

8) Development and Allocation of Staff and Orientation for LBSC Board Members

- LBSCs will be required to demonstrate a commitment to the continuing professional development of all members of staff.

Exhibit 4

ACCREDITATION CRITERIA (continued)

- LBSCs will be expected to provide appropriate induction and on-going assistance to those to whom they are accountable, (e.g. board members), to enable them to contribute effectively to strategy formulation and review.
- LBSCs will required to demonstrate that staff are allocated to clients in such a way which reflects real needs and the deployment of appropriate skills.
- LBSCs will ensure that staff development is a primary organisational concern, and install internal mechanisms to monitor and appraise performance, assess training needs and facilitate staff development.

9) Establishing Targets and evaluation

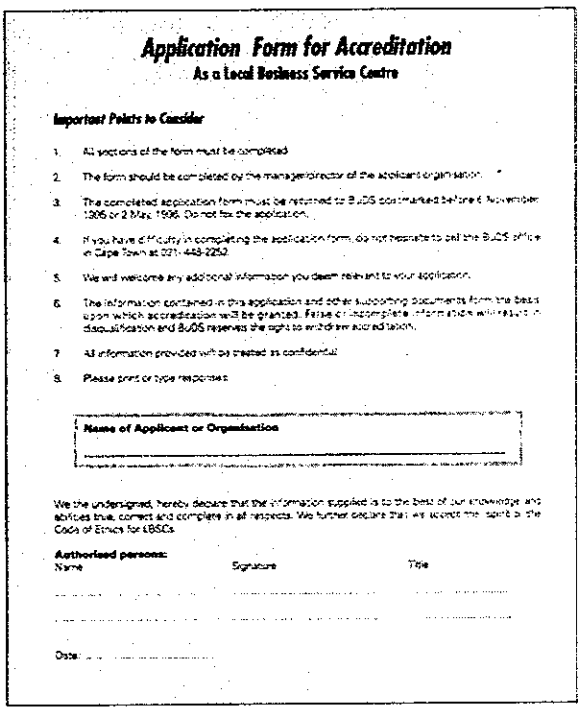
- All accredited LBSCs will be required to formulate both quantitative targets. Specific targets will be related to the LBSC's strategy and objectives.
- Clear evaluation mechanisms must be developed, implemented, and maintained.
- Evidence should be presented of clear intent to use monitoring and evaluation outputs to respond dynamic ally to client needs.

10) Dissemination of best practice and mentorship

- All accredited LBSCs will be required to demonstrate commitment to the national (LBSC) network. This includes the open exchange of experience and best practices with other LBSCs, and mentorship and support for proposed and new LBSCs, particularly in the rural areas.

Exhibit 5

EXCERPTS FROM BUDS APPLICATION AND SITE VISIT SCHEDULE



Application Form for Accreditation

As a Local Business Service Centre

Important Points to Consider

1. All sections of the form must be completed
2. The form should be completed by the manager/director of the applicant organisation.
3. The completed application form must be returned to BuDS postmarked before 4 November 1995 or 2 May 1996. Do not fax the application.
4. If you have difficulty in completing the application form, do not hesitate to call the BuDS office in Cape Town at 021-448-2252.
5. We will welcome any additional information you deem relevant to your application.
6. The information contained in this application and other supporting documents form the basis upon which accreditation will be granted. False or incomplete information will result in disqualification and BuDS reserves the right to withdraw accreditation.
7. All information provided will be treated as confidential.
8. Please print or type responses.

Name of Applicant or Organisation

We the undersigned, hereby declare that the information supplied is to the best of our knowledge and abilities true, correct and complete in all respects. We further declare that we accept the spirit of the Code of Ethics for LBSCs.

Authorised persons:

Name Signature Title

Date:

After submitting a short, written application, the applicant had to provide BuDS with a two-year business plan, a one-year cash flow and a mission statement. These documents had to show proof that the organization met the ten criteria listed above. BuDS then evaluated the written applications and, where appropriate, initiated site visits.

Accreditation as an LBSC indicated that the organization satisfied minimum quality standards. This recognition aided organizations in attracting both clients and donors. The accreditation was widely recognized by local, provincial and national government departments and LBSCs were able (wherever appropriate) to administer certain government programs. The LBSC status was like a badge that signified a level of quality, like a South African Board of Standards (SABS) stamp. Furthermore, organizational funding available to BuDS could only be disbursed to accredited LBSCs.

Depending on the number and nature of the criteria an applicant satisfied, the application was either rejected or received a "provisional accreditation." The category "provisional accreditation" was used to assist organizations developing their capabilities to satisfy the criteria. Newly established organizations had to present concrete plans to satisfy all accreditation criteria.

- LBSC's will recognize the support of BuDS by including in all publications the following acknowledgement: "This work was carried out with the support of Business Development Services."

■*Supplementary notes*

Studies throughout South Africa revealed that there are some existing service

BuDS assisted existing and potential LBSCs develop their capabilities to deliver high quality services. This was done mainly through training and development of LBSC management, staff and board members. In addition, BuDS also helped facilitate information flow between LBSCs. Finally, BuDS administered government funding for the program and monitored and evaluated LBSCs to ensure that high quality services were actually provided.

The key to the success of the Local Business Service Center Programme was the commitment of the Department of Trade and Industry to support these (approximately $25,000) each year, and a center with provisional accreditation would receive up to 50,000 rand per year for three years. It was clear from the beginning that this financial support would not be nearly enough to support the centers. They stressed the need for the centers to have income generating services andlor find additional funding from other donors. As they had seen from the cash flow projections and the past financial statements of applicants, more than 90%

of the centers operated with funding support; among them, 90% of their income came from funding. This was not a very encouraging sign in the move towards self-sufficiency and sustainability. A major objective for the LBSC program was to get the small businessmen and entrepreneurs to break their attitude of dependency on institutional support, and instill in them the idea that "you get what you pay for" when it comes to the quality of services provided by LBSCs.

Most of the organization's funds came from international donors and the South African government, sources likely to dry up in the near future. The South African government was on the verge of bankruptcy, and international aid agencies were cutting their budgets and downsizing. Success of this program depended in part, therefore, on generating income by charging fees for services and tapping other sources of funding, such as attracting grants from the prosperous private sector of South Africa and donors from other parts of the world.

Given the country's racially strained history, many large corporations and conglomerates run by formerly pro-apartheid, pro-national party people were now looking for ways to make amends, to give back to their communities. A number of them were setting up their own development centers. Other firms gave financial and skills support and provided entree into various development organizations. For instance, Ernst & Young and Coopers & Lybrand both had training programs for small businessmen and entrepreneurs. DeBeers and Anglo American, two very large private sector corporations, were interested in starting their own centers and intended to fully fund them. Richards Bay Minerals was currently running an LBSC in the province of KwaZulu Natal and had been doing so for the past ten years. Big business in South Africa was highly profitable and many believed it was imperative that they join with the LBSC program and others like it. The private sector had the money to support small business programs for previously disadvantaged groups. With their assistance, these groups had the potential to become a valuable part of the South African economy.

Site Visits to Local Business Service Centers

So here they were in Welkom, face to face with racism. Joe was very angry at the hotel staff and had a few blunt words with them. Nicole had never seen him so upset. Rumi and Nicole disappeared into the background. The unpleasant scene was not what they needed after a long day on the road. They all went to sleep early that evening, with bad images of recent South African history etched in their minds.

The next morning they visited the applicants from Welkom and over the next few days the rest of the Free State Province. When they arrived at the Thaba Nchu site, Nicole knew right away she was going to be challenged as a professional. There were 20 men at the site who had assembled to meet with the team to discuss their proposal. As tradition goes, there was an older man from the community who spoke on behalf of the people of the region. He would not even look at Nicole. When it came time for her to greet him, Nicole extended her hand for a handshake but he just walked away. Nicole was embarrassed and angry. As the only female in the room, she wanted to shout, "Don't ignore me!" They would need more coffee and tea for the meeting and Nicole was told by the older man that she should go and assist the women in the kitchen. Nicole thought about causing a scene, but she decided to wait until after the team left the site to raise the issue with Joe and her other team members. When she complained that the older gentleman had ignored and insulted her, they said they had not noticed, they laughed off his behavior as the "traditional way" and never discussed it again.

After the Free State Province, they flew to KwaZulu Natal Province for another three days of site visits. By this time, the group had really come together as a team. They entered each subsequent site visit with increased confidence. Apart from the gender problem that they encountered in Thaba Nchu about which Nicole was still angry, each felt part of a cohesive unit, each person playing a specific role and working toward a common goal.

Their last site visit dramatized the challenges of teaching professional management in the provinces. The applicant, Mr. Singh from Masibumbane Foundation, had called Nicole at the office in Cape Town so many times she had lost count. His application was a mess. It came late, half faxed, half mailed and was incomplete, yet she agreed to visit his center to appease his pleading. They had been receiving literature from his organization since early June and she sent him not one, but two applications after he told her that the first never was delivered. Then he did not receive the second, making him quite distraught and upset, so she faxed him the application form, an act against policy. She was thus quite familiar with Masibumbane and Mr. Singh even before they met in person in late November.

Durban was the major metropolis of the KwaZulu Natal Province. It was home to Buthelezi and the Inkhata Freedom Party, the opposition party of the African National Congress. It was a city where bloodshed was a part of life and death all too common. It was also situated on the coast of the Indian Ocean and had some of the most beautiful beaches in the country, along with the best surf. Masibumbane Foundation was located in one of the many ghettos in Durban, and Nicole's first

Exhibit 5

EXCERPTS FROM BUDS APPLICATION AND SITE VISIT SCHEDULE

Application Form for Accreditation

As a Local Business Service Centre

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7. All information provided will be treated as confidential.
8. Please print or type responses.

Name of Applicant or Organisation

We the undersigned, hereby declare that the information supplied to the best of our knowledge and abilities was correct and complete in all respects. We further declare that we accept the spirit of the Code of Ethics for LBSCs.

Authorised personnel:

Name Signature Title

Date:

Exhibit 5

PROPOSED CENTER'S CASH FLOW STATEMENT

Cash Flow for the 12 months ended 31 December 1996

Month 5 Month 12 Cash Flow	Month 6 Total	Month 7	Month 1 Month 8	Month 2 Month 9	Month 3 Month 10	Month 4 Month 11								
Balance B/D			25,000	25,000	25000	25,000								
–	–	–	–	–	–	–								
–	100,000													
BuDS			14,237	27,224	27,711	34,948								
15,183	272,922	255,667	274,376	277,833	310,270	298,007								
Donors:														
	International		–	–	–	–								
–	50,000		–	50,000	–	50,000								
–	–		150,000											
	Corporate		10,000	10,000	–	–								
–	175,.000		–	–	–	–								
–	–		195,000											
	Local		5,000	–	–	–	–	50,000	–	–	–	–	–	–	155,000
Fees:														
	Counselling		–	–	500	500	500	1,000	1,000	1,000	700	700	1,000	1,000	7,900
	Training		–	–	2,000	2,000	2,000	2,000	5,000	5,000	5,000	5,000	5,000	5,000	38,000
	Workshops		–	–		3,000	–	3,000	–	5,000	–	–	5,000	–	160,000
	Referrals		–	–	–	–	1,000	–	–	1,000	1,000	–	–	1,000	4,000
Total Cash Inflow			40,000	35,000	275,000	30,500	3,500	281,000	6,000	620,000	6,100	55,100	11,000	7,000	565,700
Cash Outflow			25,763	22,013	27,013	23,263	23,263	23,263	23,263	23,263	23,263	23,263	23,263	23,263	284,156
Programme:				2,500	7,500	10,000	10,000	10,000	10,000	10,000	10,000	10.000	10,000	10,000	100,000
	Core Service A		–	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500	275,000
	Core Service B		–	–	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500	250,000
	Core Service C		–	–	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500	250,000
	Core Service D		–	–	–	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500	22,500
Capital:			133,000	7,050	7,050	800	800	800	800	800	800	800	800	800	34,600
	Vehicles		800	800	800	800	800	800	800	800	800	800	800	800	9,600
	Furniture		–	–	.	–	–	–	–	–	–	–	–	–	–
	Equipment		12,500	6,250	6,250	–	–	–	–	–	–	–	–	–	25,000
Operational:			12,463	12,463	12,463	12,463	12,463	12,463	12,463	12,463	12,463	12,463	12,463	12,463	149,556
	Software		–	–	–	–	–	–	–	–	–	–	–	–	–
	Salaries		6,500	6,500	6,500	6,500	6,500	6,500	6,500	6,500	6,500	6,500	6,500	6,500	780,000
	Transport		500	500	500	500	500	500	500	500	500	500	500	500	6,000

impression was that it was strange. There were no signs, no advertisements, and they had to ask for directions from four different people before they found the center. Not even the center's next-door neighbors knew where it was. Mr. Singh was noticeably nervous for their visit, with good reason as far as Nicole was concerned. He had a weak cash flow statement, thrown together haphazardly (see Exhibit 5). His business plan was sketchy at best. It was obvious that Masibumbane needed more work before they could properly evaluate his application.

Mr. Singh took them on a tour of the facilities. He proudly showed them portable push carts for car washing and selling vegetables. These were to be sold to the entrepreneur at a small profit for the center and then the entrepreneur would own and operate his/her own small business. This was not new; they must have seen this scheme at three or four other centers. No doubt someone ran a workshop in the area pushing this concept. None of the group members was too impressed with his setup, and they left in a hurry, telling Mr. Singh that he would have to submit a proper cash flow statement and business plan, outlining how his organization would meet the ten criteria and, most importantly, how he planned to implement the four core services, before they could properly evaluate Masibumbane.

With the last visit over, they in short order had to inform the applicants of their decisions. In accreditation committee meetings, Joe said he did not want to give accreditation to centers that had typical South African "white men" running the show. Rather than generating a heated racial discussion here in Cape Town, this remark met with nods of agreement. Given the history of the area (see **Background on South Africa**), Joe's comments were not surprising. Was not the goal of this program to assist the disadvantaged people, not further enrich the white minority? In the end, it was decided that if the center served a largely black and colored community, and if the manager was respected in his community, they would consider accreditation.

The Department of Trade and Industry set the date of December 1 as the target date for notifications. On December 7, Nicole created three form letters for their decisions: (a) full accreditation, (b) provisional accreditation, or (c) rejection. The letters were faxed, and everyone working on the program gave out a huge sigh of relief. They did it–they met the impossible deadline!

The results were as follows: 27 accredited centers, 15 with full and 12 with provisional accreditation. Forty four percent of the accredited centers were considered rural, and 20% of the urban centers were in the townships on the outskirts of metropolitan areas where disadvantaged groups from the apartheid era were forced to inhabit.

Joe and Nicole congratulated each other on their hard work and accomplishments. They were both looking forward to handing over the promised financial assistance and holding a formal public launch for the program.

Questions for Discussion

(1) Gender issues: How would you have handled yourself at the meeting at Thaba Nchu if you had been ignored by the town elder? Would you have reacted differently? Discuss the implications of the alternative actions you might have taken during this meeting and in subsequent discussions with the team.

(2) Racial issues: Discuss now racial issues might have affected the committee's decisions. Describe how you would have felt and dealt with the racially charged situation of the "misplaced" hotel reservation in Welkom.

(3) Economic disparities: In order to evaluate the applicants fairly, how would you compensate for the technology gap between cities and rural areas? Explain how you would factor in differences in the economy, infrastructure and educational background in making decisions for each area.

Appendix

Background on South Africa

Source: USAID Country Profile 1991-1993

Official Name: Republic of South Africa

Geography

Area:	1.2 million sq. km.	
Capitals:	Administrative — Pretoria	
	Legislative — Cape Town	
	Judicial — Bloemfontein	
Other cities:	Johannesburg, Soweto, Durban	
Population:	42.7 million	
Ethnic Groups:	African (black)	29.1 million
	white	5.5 million
	colored (mixed race)	3.3 million
	Asian (Indian)	1 million

Languages: Afrikaans, English, Ndebele, North Sotho, South Sotho, Swati, Tsonga, Tswana, Venda, Xhosa and Zulu (all official languages).

Religions: Predominantly Christian; traditional African, Hindu, Muslim, Jewish.

Education: Seven years compulsory for all children but not currently enforced. An estimated two million school-age children do not attend school.

Independence: The Union of South Africa was created on May 31, 1910. It became a sovereign state within the British Empire in 1934, became a republic on May 31, 1961, and left the British Commonwealth in October 1968. Nonracial, democratic constitution came into effect April 27, 1994.

South Africa is located in the southernmost portion of Africa, and is surrounded on three sides by the Atlantic and Indian oceans. On the north and northeast, the country borders Namibia, Botswana, Zimbabwe, Mozambique and surrounds Swaziland. South Africa's 471,455 square miles makes it about three times the size of Texas. The population is 41 million with an annual growth rate of 2.3 percent. The climate is cool and dry. Per capita income was $2,880 in 1993, a figure masking large disparities in income between whites, whose per capita income is $13,155, Indians with a per capita income of $8,550, coloreds with a per capita income of $4,450 and blacks with a per capita income of $1,950. (These figures are rough estimates.)

In April 1994, South Africa's first ever multiracial elections resulted in the election of a new president and the creation of a Government of National Unity composed of ministers from the major political parties: ANC, National Party, Inkhata Freedom Party, Pan African Congress and Democratic Party. Shortly thereafter, President Mandela announced the ambitious Reconstruction and Development Program. The program identified four broad areas of emphasis: meeting basic human needs, developing human resources, building the economy and democratizing the state and society. The new government has an enormous task ahead of it, including reforming the ministries and the civil service, establishing a constitutional court, reorganizing the country from a system of four provinces and ten "homelands" into nine provinces, transforming the health and education systems and integrating millions of formerly disenfranchised citizens into the economic and social fabric of the nation. A well functioning democracy and dramatic and sustained economic growth are key to meeting many of these challenges.

Although South Africa has the largest economy in the region, it was just emerging from a recession and the effects of a prolonged struggle against apartheid. GDP growth was around two to three percent in 1995, but could reach higher levels in future years if political stability is maintained and renewed foreign investment is forthcoming. South Africa has a dual economy; its financial, industrial, and agricultural sectors exhibit many of the characteristics of developed economies, while much of the economy and most of the population exist in conditions similar to those in most developing countries. Growth, investment and economic assistance are needed to reduce the alarming poverty in South Africa. At present, approximately 40% of households lack adequate housing, 49% lack safe water and 25% lack adequate sanitation. More than one-third of the adult work force is jobless, and more than 50% is functionally illiterate. If South Africa is to serve as a model for successful conflict resolution and reconciliation in the region, as well as an engine for rapid economic growth, these conditions must be improved.

South Africa has the most developed and diversified economy in Africa, and it possesses the continent's most modern and efficient road, rail and telecommunications networks. Its 1993 GDP of $117 billion was more than four times larger than the combined GDP of the rest of the southern Africa region. South Africa is the United States' largest trading partner in Africa, with bilateral trade of $4 billion in 1993. U.S. private sector investment in the country exceeds $1 billion.

Business success hinges on the extent to which a favorable business climate can be created. Black businesses have been historically discriminated against on five counts: regulations prohibited or hindered the development of nonwhite businesses, the educational system provided inferior education for blacks, lack of proper skills limited access to and appreciation of new technologies, the formal banking system ignored the majority population and the concept of capitalism was equated with apartheid. All of these factors must be addressed to effect long lasting, economic empowerment of the disadvantaged majority in South Africa.

At the time of this case study, the cities of South Africa were definitely first-world cities in terms of infrastructure and technology, while the rural areas seemed like they could be in any developing country, with poor infrastructure, lack of education and other problems. Apartheid successfully divided this country in terms of race, and in doing so, created gross inequities in education and living conditions. The technology gap between urban centers and rural areas was enormous. Many townships and rural areas were just now getting electricity and running water, while the urban areas were filled with computers, Internet connections and other such amenities. The rural areas couldn't be compared to the urban centers, but it went further than that because of the inner-city townships that were created by apartheid and that still exist today.

The disparities in access to economic resources in South Africa were numbing. Average white incomes were six times those of blacks, three times those of coloreds and almost twice those of Indians. More than half of the majority population lived below the official poverty line. It would be impossible to establish and sustain a stable, democratic, post-apartheid South Africa if the majority population had so little a stake in the country's economy.

PEOPLE

Until 1991, South African law divided the population into four major racial categories: Africans (blacks), whites, coloreds and Asians. Although this law has been abolished, many South Africans still view themselves and each other as belonging to one of these categories. Africans comprise about 75% of the population and are divided into a number of different ethnic groups. Whites comprise about 14% of the population. They are primarily descendants of Dutch, French, English and German settlers who began arriving at the Cape in the late 17th century.

Coloreds are mixed-race people, primarily descending from the earliest settlers and the indigenous peoples. They comprise about nine percent of the total population. Asians descend from Indian workers brought to South Africa in the mid-19th century to work on the sugar estates in Natal. They constitute about two percent of the population and are concentrated in the KwaZulu Natal Province. Education is in a state of flux. Under the apartheid system, schools were segregated and the quantity and quality of education varied significantly across racial groups. Although the laws governing this segregation have been abolished, the long and arduous process of restructuring the country's educational system is just beginning. The challenge is to create a single nondiscriminatory, nonracial system which offers the same standards of education to all people.

HISTORY

The British gained control of the Cape of Good Hope at the end of the 18th century. Subsequent British settlement and rule marked the beginning of a long conflict between the Afrikaners and the English. Beginning in 1836, partly to escape British rule and cultural hegemony and partly out of resentment at the recent abolition of slavery, many Afrikaner farmers (Boers) undertook a northern migration which became known as the Great Trek. This movement brought them into contact and conflict with African groups in the area, the most formidable of which were the Zulus. Under their powerful leader, Shaka (1787-1828), the Zulus conquered most of the territory between the Drakensburg Mountains and the sea (now KwaZulu Natal). In 1828, Shaka was assassinated and replaced by his half brother Dingane. In 1838, Dingane was defeated and deported by the Voortrekkers (people of the Great Trek) at the battle of Blood River. The Zulus nonetheless remained a potent force, defeating the British in the historic battle of Isandhlwana before being conquered themselves in 1879.

In 1852 and 1854, the independent Boer Republics of the Transvaal and Orange Free State were created. Relations between the republics and the British government were strained. The discovery of large gold deposits in the Witwatersrand region of the Transvaal in 1886 caused an influx of European (mainly British) immigration and investment. Many blacks also moved into the area to work in the mines. The construction by mine owners of hostels to house and control their workers set patterns that later extended throughout the region. Boer reactions to this influx and British political intrigues led to the Anglo-Boer Wars of 1880-81 and 1899-1902. British forces prevailed in the conflict and the republics were incorporated into the British Empire. In May 1910 the two republics and the British colonies of the Cape and Natal formed the Union of South Africa, a self-governing dominion of the British Empire. The Union's constitution kept all political power in the hands of the whites.

In 1912, the South African Native National Congress was formed in Bloemfontein and eventually became known as the African National Congress (ANC). Its goals were the elimination of restrictions based on color and enfranchisement of and parliamentary representation for blacks. Despite these efforts, the government continued to pass laws limiting the rights and freedoms of blacks. In 1948, the National Party (NP) won the all-white elections and began passing legislation codifying and enforcing an even stricter policy of white domination and racial separation know as "apartheid" (separateness).

In the early 1960s, following a protest in Sharpville in which 69 protesters were killed by police and 180 injured, the ANC and Pan-African Congress (PAC) were banned. Nelson Mandela and many other anti-apartheid leaders were convicted and imprisoned on charges of treason. The ANC and PAC were forced underground and fought apartheid through guerrilla warfare and sabotage. In May 1961 South Africa relinquished its dominion status and declared itself a republic. Later that year, it withdrew from the Commonwealth, in part because of international protests against apartheid.

In 1984, a new constitution came into effect in which whites allowed coloreds and Asians a limited role in the national government and control over their own affairs in certain areas. Ultimately, however, all power remained in white hands. Blacks remained effectively disenfranchised. Popular uprisings in black and colored townships in 1976 and 1985 helped to convince some NP members of the need for change. Secret discussions between those members and Nelson Mandela began in 1986. In February 1990 State President F.W. de Klerk—who had come to power in September 1989—announced the un-banning of the ANC, the PAC and all other anti-apartheid groups. Two weeks later, Nelson Mandela was released from prison. In 1991, the Groups Areas Act, Land Acts and the Population Registration Act—the last of the so-called

"pillars of apartheid"—were abolished. A long series of negotiations followed, resulting in a new constitution made into law in December 1993. The country's first nonracial elections were held on April 26-29, 1994, resulting in the installation of Nelson Mandela as President on May 10, 1994.

ECONOMY

South Africa has a broad-based, industrialized economy that paradoxically exhibits most of the characteristics associated with developing economies: a division of labor between formal and informal sectors, uneven distribution of wealth and income, a dependency on commodity exports and a legacy of government intervention.

The formal sector, based on mining and manufacturing, is well developed. A smaller but important agricultural and service sector exists. Despite a strong private sector, there has been substantial government intervention in the economy. There also are a number of large government-owned corporations.

Economic policy has concentrated on the formal sector, but since the mid-1980s, the policy has sought to develop the informal sector, focusing on education and training, job creation and small business assistance. The transition to a democratic, nonracial government, begun in early 1990, stimulated a debate on future economic policies to achieve sustained economic growth, redress the socio-economic disparities created by apartheid and improve the standard of living for the majority of the population.

The government is pursuing market-based policies, with the private sector the generator of wealth and the government the force addressing inequities in health, education, housing and social services. It embarked on a five year, $10.5 billion Reconstruction and Development Program to implement programs to reduce unemployment, provide free medical care to pregnant mothers and children under age six, electrify many homes in townships and build a million new homes. To accomplish these goals without undermining business confidence, the government's first year budget called for continued fiscal discipline and strict monetary controls. South Africa aims to establish and maintain a pro-business environment and encourage both foreign and domestic investment.

A total of 9.4 million people are employed in the formal and informal sectors of the South African economy. Employment in the nonagricultural sectors remained virtually constant between 1980 and 1992. The unemployment rate is now in excess of 40%, and approximately 350,000 new people enter the labor market each year. The high and increasing unemployment rate is therefore one of the single most important problems facing the South African government, and only steady economic growth over an extended number of years can create the job opportunities necessary to overcome this problem.

Whereas the average unemployment rate is over 40%, in several areas in the black and colored communities it is substantially higher. South Africa has one of the most unbalanced distributions of income and wealth. The richest 10% of the households earn about 51% of the total income, while the poorest 40% of the population earn only about four percent of total income.

There is a strong correlation between race and socioeconomic situation. Within the poorest 20% of households, only 5% are whites, while the whites constitute 76% of the richest 20% of all households. Almost 41% of all South African households live in poverty, but within the racial groups the percentage of households living in poverty is 6.7 for whites, 18 for Asians, 38 for coloreds and 76 for blacks.

It will take political will and determination and cooperation from all groups of the South African society to change the existing situation. But most of all, it will require the creation of economic growth, because only through economic growth will it be possible to create the necessary jobs and the wealth needed to pay for affirmative action programs. As an illustration of the magnitude of the problem, it has been estimated that eliminating poverty in South Africa would require growing the economy five percent per year for 24 consecutive years.

Employment and Labor

EMPLOYMENT

A weak economy caused employers to slash their work forces in 1991. The mining and manufacturing industries eliminated some 65,000 jobs, and similar cuts were anticipated for 1992. The South African Chamber of Business estimated that 40% of the potential economically active population—or more than five million workers—were unemployed. With employment opportunities in the formal sector shrinking, South Africans are increasingly turning to jobs in the informal sector, such as vending, small repairs and carpentry. In 1980, 22% of South Africa's economically active population was employed in the informal sector. That number has now jumped to 29%. Ironically, while there is massive unemployment among unskilled workers, jobs for skilled technical and managerial workers often went begging due to inadequate skills and vocational training.

WAGES

Average wage increases of about 16.1% during 1991 were down from the previous year's average of 17.5%, but still remained slightly above the inflation rate. Wage gains by black workers were relatively better

Exhibit A-1

KEY ECONOMIC INDICATORS
(In billions of U.S. dollars unless noted)

		Projected		
	1989	**1990**	**1991**	**1992**
Domestic Economy				
Gross Domestic Product (1)	88.9	101.9	107.5	123.1
Real GDP Growth Rate (%)	2.3	-0.5	-0.6	0.5
Population Estimate (millions) (3)	37.1	38.0	38.9	39.8
Population Growth Rate (%)	2.5	2.4	2.4	2.4
GDP Per Capita (dollars) (1,3)	2,396	2,682	2,763	3,093
Consumer Price Index Change (%) (2)	14.7	14.4	15.3	14.0
Gross National Product (1)	84.9	99.0	103.9	118.5
Production and Employment				
Labor Force, excluding homelands (millions) (3)	10.9	11.1	11.3	n/a
Unemployment, including homelands (%) (3)	35.0	37.0	40.0	n/a
Manufacturing Volume Index (1985=100)	109.4	108.0	105.2	n/a
Mining Volume Index (1990=100)	101.9	100.0	98.3	n/a
Government Deficit as % of GDP (Fiscal year ends March 31)	1.8	2.6	4.3	4.5
Balance of Payments and Foreign Investment				
Exports (FOB)	22.2	23.8	24.1	n/a
Imports (FOB)	16.9	17.2	17.4	n/a
Current Account Balance	1.2	2.3	2.7	1.5
Gold and Forex Reserves Held by Reserve Bank (2)	2.0	2.4	3.5	n/a
U.S. Direct Investment (2)	0.7	0.8	n/a	n/a
External Debt (2)	19.9	19.4	n/a	n/a
Ratio of Foreign Interest Payments to Exports (%)	7.1	7.1	n/a	n/a
Exchange Rate (average dollars/rand)	0.38	0.39	0.36	0.35
U.S. Exports to South Africa	1.66	1.73	2.11	n/a
U.S. Imports from South Africa	1.52	1.70	1.73	n/a

n/a = not available
(1) Current prices; increases in GDP at current prices are due to domestic inflation not reflected in the dollar/rand exchange rate.
(2) Year end.
(3) Statistics are subject to interpretation.

Sources: South African Reserve Bank, Central Statistical Services and various private forecasts.

than those by whites, as companies and trade unions worked to close the gap in remuneration that has existed between the races.

PRODUCTIVITY

According to the South African Reserve Bank, labor productivity (i.e., real GDP per worker outside the agricultural sector) showed year-to-year increases of 1.7% in second quarter 1991 and 1.6% in the third quarter. The bank attributes this increase to work force numbers falling more rapidly than production volume. Meanwhile, the year-to-year increase in nominal unit labor costs was 14.2% for the first three quarters of 1991. There was virtually no increase in real unit labor costs during the first three quarters of 1991.

Money, Prices and Government Finance

MONEY

Restrictive monetary policy led to a further slowdown in the growth of the broad money supply (M3) and a slight easing of credit in 1991. The increase in M3 rates fell from a peak of 27.5% in August 1988 to 10.2% in January 1991. Regulatory changes introduced in the Deposit-Taking Institutions Act on February 1 brought many additional items onto banking balance sheets, artificially boosting the money supply. Allowing seasonally adjusted and annualized growth rate in M3 from the end of February 1991 to the end of January 1992 amounted to only 9.7%, reflecting lower domestic economic activity and declining demand for money. In March 1992, the South African Reserve Bank lowered its guidelines for annual M3 growth to 7-10%, the lowest since the bank first introduced its guidelines in 1986. The bank also reduced its prime bank rate from 17% to 16% in March 1992.

PRICES

Inflation in South Africa remains much higher than that of its major trading partners. The increase in the consumer price index (CPI) rose from 14.4% in 1990 to 15.3% in 1991. Consumer prices jumped to 16.8% in the year to October 1991, following the implementation of the value-added tax and have since hovered around 16%. In spite of tight monetary policy and recessionary conditions, CPI inflation has been pushed by continuing nominal wage boosts, annual food price increases exceeding 25%, and consumer expectations. In contrast, the rate of increase in the production price index (PPI) has continued to decline, falling from 15.2% in 1989 to 12.0% in 1990 and 11.4% in 1991. Economists were hopeful that the downward PPI trend would translate into a smaller CPI increase in 1992. Estimates for inflation in 1992 ranged around 13%.

GOVERNMENT FINANCE

South Africa's economic policy-makers are determined to keep a tight rein on government spending, but increasing demands for social spending have made that goal elusive. In the 1991/92 fiscal year (April to March), spending reached R89.4 billion, a nominal increase of 16.8% from the year before-a 1% boost in real terms. Revenues for fiscal 1991/92 equaled R73.2 billion, an increase of only 9.6% from the previous year's collections. Total government income fell short of expectations by R1.7 billion because of the continuing economic recession and losses incurred from the replacement of a 13% general sales tax with a value-added tax pegged at 10%. As a result, the government's deficit before borrowing grew to 4.3% of GDP (R13.1 billion), compared with a 3.4% in the original 1991/92 budget estimate and 2.6% the year before.

Balance of Payments

South Africa's balance of payments position improved considerably during 1991. The current account surplus grew from R5.8 billion in 1990 to R7.4 billion in 1991, the largest annual surplus in the country's history. The sharp increase resulted from a decline in merchandise imports due to the deepening recession, higher merchandise and net gold exports, and lower net service and transfer payments to nonresidents. Economists predicted a current account surplus of about R4 billion for 1992.

South Africa operates a two-tier foreign exchange system, the commercial rand and the financial rand, with the latter reserved for investment and capital exports of nonresidents. The discount on the financial rand narrowed significantly in early 1991 and has since traded at a discount around 16% to the commercial rand.

NOTES

1. This case was written by Nicole Scheps of Rutgers University. It is intended as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

Business Development Services (B)[1]

Cape Town, South Africa

CASE B. MARKETING THE LBSC PROGRAM

Launching the LBSC Program

Mr. Trevor Manuel, the Minister of Trade and Industry, told the BuDS office that December 15 would be the official launch of the program. The date came and went with nothing happening. The accreditation team was told the program would begin in late January for sure, but this, too, did not happen. It was at this point that Nicole began to have serious doubts whether the current leadership in government was still committed to the program. Meanwhile, the centers were operating and excited about their new status. BuDS held a workshop in February, the first for the newly accredited LBSCs. It was at this workshop that the centers began to question when they would receive the promised financial assistance. Let the political games begin! Finally in late February the Department decided that March 15th was the definite date for the launch and that the BuDS office should start the preparations.

They should start? What was the government talking about? The BuDS team was the facilitator of the program; they administered workshops and handled the day-to-day problems of the LBSC network. How could they also be expected to prepare the launch ceremony for this first program of the new government, the Reconstruction and Development Program (RDP)? This was the Department's launch, it was their program, their opportunity to show the people of South Africa and the world what they had done and how they were delivering on their promises of the 1994 election.

Nicole was astonished by the lack of support and initiative from the Department. She reminded herself a hundred times since arriving in South Africa that this was not her native New Jersey and things were done differently here. If she began to question every decision or instruction given to her and the LBSC program, she would get hung up on little details and fail to develop businesses in South Africa.

It was February 22 and they had exactly three weeks to prepare the national launch for the LBSC program. One woman from the department was given the task of putting it together. No committee was formed; rather one person had absolute control. That meant one person had to issue press releases, order the caterers, invite the public and in general make the event happen. They worked 80 hours a week for this program and it was time to sell it to the general public, the private sector and the international donors who they hoped would fund these selected centers, but the Department dragged its feet. Where were the brochures, where were the media advertisements? Where, for that matter, was the marketing strategy for the program?

Nicole attended the launch as a guest. Joe and she were there, but the rest of the accreditation team was not invited. About 100 people attended the celebration. It was held at one of the rural accredited centers, under a big tent on its property. It was so rural that most of the guests got lost, including the television reporters. The print media failed to attend because it did not seem reasonable to drive that far out from the urban center to cover a story that they knew nothing about because

there were no prior press releases. The Minister attended the ceremonies and gave out the first portion of the payments, which was most important, but it was obvious that marketing and advertising did not play an important role in the South African business world. During the launch there was very little attention paid to the private sector, the wealthy sector in South Africa. Nicole thought that this was a big mistake and a costly error on their part.

Figure 6

Dr. Naidoo and Mr. Stoffels handing COMSEC the first installment of their financial assistance at the launch of the LBSC program.

Figure 7

Mr. Stoffels and the Minister of Trade and Industry, Mr. Trevor Manuel, at the launch of the LBSC program.

Figure 8

Nicole and Mr. Stoffels at the launch of the LBSC program.

Marketing the LBSC Program

It was the Monday after the launch that Nicole decided to bring up the point that very few of the LBSCs had marketing plans and now after being involved with the launch of the program, she understood that the concepts and practice of marketing and advertising were new to many businesses in South Africa. For that matter, freedom of speech was new, too! In order for the LBSCs to be successful in reaching the disadvantaged communities, they would first have to reach them through marketing and advertising.

Nicole recommended to the executive director, Dr. Raven Naidoo, that the first workshop for the managers of the LBSCs should be on marketing and each center should produce a marketing plan or strategy by the end of the workshop. As for BuDS and the LBSC program itself, Nicole brought the marketing mishap of the launch to the attention of both Raven and Joe. She suggested that it was imperative to involve the private sector in this program if it were to succeed. They were trying to sell a product, namely, the LBSC program itself. Like any other product, they had to market it, and the first thing they needed was a marketing strategy. The future of the program depended on the private sector accepting and buying into this network of nonprofit organizations. They had to accept the concept and work with the centers, giving financial and human resource support. The others agreed with her ideas and suggestions. Raven, in the typical development sector fashion ("too few people, too much to do"), told Nicole to get to work on it. She called the United Nations Development Program (UNDP) representative in South Africa and made arrangements for a marketing workshop, then began work on a proposal for the board of directors.

Understanding the marketplace was the first step. In a country like South Africa, it was imperative to take into consideration the history behind the current economic situation. Nicole needed information about the business and cultural environment. She enlisted the help of her South African colleagues. She discovered that no matter who you were or what job you held, you had a political opinion. From the cleaner all the way up to the executive director, everyone talked and was knowledgeable about politics. (See Appendix from (A) case.)

As for the business environment, South Africa was run as a monopolistic society from 1948 through 1994. They had state-run monopolies where competitive markets did not exist. Thus marketing and advertising were not a significant part of the operation of most businesses. This was the root of the problem. While South Africa had numerous mature industries, very few were familiar with the importance of marketing in all businesses.

In addition to this information on the South African cultural situation, the following were the actual items to be marketed to the private sector:

Product

The product that they were trying to sell was the LBSC program itself. The crux was the concept of a network of small business support centers throughout the country. They were working together to bring high quality support services, such as counseling, training and access to information, to everyone in the nation on an equal basis.

Price

The cost of the product would vary for each individual buyer since each sought different degrees of assistance. For instance, some companies would give only financial assistance, while other organizations might send an employee to work in the local business service center and still others might provide training or contracts for the clients of the service center. So there were a number of ways in which a company from the private sector might choose to become involved in the program, and therefore prices for services varied.

Promotion

The program needs a significant amount of publicity, specifically because after ten months of work, the man on the street knows nothing about the program or Business Development Services. Nicole felt that by not advertising the programs and getting their name before the public, this had hindered their abilities to involve the private sector and was something that should be rectified immediately. Promotion can be achieved with print and media advertising and brochures. In addition, Nicole felt that since this was a quasi-government program, it should have the full backing of the South African government and therefore should offer tax breaks to companies that buy into the program.

Place

Second to promotion, Nicole felt that variations in local conditions posed by far the biggest obstacle to the LBSC program. South Africa was a unique country with contradictions and problems that make a national program very difficult. Now in 1996, the task of creating a national program to provide equal services to everyone was in fact not only difficult, but next to impossible. A strategy for overcoming differences in living conditions had to be a major part of the marketing plan.

It was now April, and Nicole had been working on her proposal for three weeks. The Board of Directors meeting was set for two days hence, and Raven came to tell her that they were very interested in her proposal. She had worked closely with Raven and Joe in developing her thinking, taking into consideration their comments and criticisms. They all felt it was a strong proposal, but they knew it might meet powerful opposition. Nicole had to be convincing in defending her position that BuDS should spend substantial money on a large marketing campaign.

It was the day of the meeting and Nicole was nervous. Raven warned her to be brief and to the point, and wished her good luck.

Assignment:

(1) Identify your own marketing strategy for the LBSC program to take to the board meeting. Be sure to include an advertising budget and reasons for all your suggestions.

(2) Read the excerpts from the application of a specific Business Advice Center shown in the Appendix. Then complete the following:

a. Make your decision on the application: rejection, partial accreditation, full accreditation. Prepare an answer as if you were going to take your decision to the Accreditation Committee.

b. Create a marketing plan for the center to reach its target groups.

NOTES

1. This case was written by Nicole Scheps of Rutgers University. It is intended as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

Sithole Upholsterers[1]

Johannesburg, South Africa

Main Characters

Ray Sithole	Chairman and founder of Sithole Upholsterers (pronounced "sit-O-lay")
Issy Sithole	One of Ray Sithole's four sons who works at the factory
Ervin Carroll	American small business consultant with Kavuma Consulting in Johannesburg
Greg Howell	Bank manager supervising the Sithole account

First Meeting

As Ervin Carroll drove through Industria, an appropriately named district in Johannesburg filled with many factories, warehouses and large delivery trucks, he wondered what to tell the bank manager who wanted to call a delinquent loan and shut down Sithole Upholsterers. Sithole was a furniture design and manufacturing company owned and operated by a family of colored[2] South Africans. Carroll was an American consultant who had been called by Issy Sithole in a last attempt to help keep the company afloat.

Issy had heard that Kavuma Consulting had a contract with the U.S. Agency for International Development (USAID) to provide free or subsidized consulting to businesses that had been previously disadvantaged under apartheid. Carroll had several years' experience consulting in the area of small business development. He had lived in neighboring Botswana for two years as a Peace Corps volunteer and welcomed the opportunity to return to Africa after receiving his MBA in the United States.

After arriving at the factory, Carroll was introduced to Greg Howell, the white South African bank representative in charge of the Sithole account. Howell seemed uneasy and he asked that the meeting get underway right away. They were ushered into the board room by Ray Sithole, the chairman of the company. Ray's sons, Issy, Phillip, Pierre and Andre, soon joined them.

Howell began by stating the bank had tried to work with Sithole but the situation had become untenable. The bank had provided Sithole with an overdraft facility which effectively allowed them a R30,000[3] line of credit. However, the overdraft was consistently exceeded and a series of checks was returned unpaid. When the bank sought assurance that this situation would be rectified, Ray explained that their customers were not paying on time and that he was already doing everything he could to collect from them.

"It's not our fault," Ray complained. "Our customers are paying very slowly. Sometimes we fill orders and then the customer says they didn't place the order or they don't want it. Then we have to store the merchandise until we can sell it, usually at a discount."

Howell replied, "I know about these problems, but based on what you told me three months ago, you should be profitable enough by now to operate your business and meet your debt obligations. If your customers aren't paying, then stop selling to them or convince them to pay on time. If you can't do that, you shouldn't be in business."

"I'm not a *sangoma*,"[4] Ray yelled. "I've tried to get them to pay sooner, but they threaten to stop buying from us and without them we're finished!"

"Well, I'm sorry," continued Howell, "but we can't afford to finance you when you continue to bounce checks."

"Then raise our credit line!" Ray shouted as he banged his fist on the table. "We make great products and I've worked too hard. You can't close our business! You wouldn't be treating us this way if we were Afrikaners!"[5]

"That's rubbish," bellowed Howell. "That has nothing to do with it."

"Gentlemen, please," interrupted Carroll. "This isn't getting us anywhere." He turned to Howell and said, "Look, Greg, why don't you give me some time to look at the business and see what improvements can be made that would increase cash flow."

"I'm sure that there are many improvements that can be made," said Issy. "We know how to make furniture as well as anyone, but we don't have management expertise."

Howell thought for a few moments and then agreed to meet again in two weeks to find out whether or not Carroll thought the company was viable. Howell excused himself and the others breathed a sigh of relief as he walked out the door.

Company Background

Sithole Upholsterers designed and manufactured lounge suites (sofas, love seats and chairs). Much of their work was based on custom designs using fabric chosen by their clients, mostly interior decorators who resold the furniture to their clients.

The company was started in 1980 by Ray Sithole. He had been a foreman for an upholstery manufacturing company, and his wife, Grace, was a seamstress. In addition to the normal barriers any startup company faces, the Sitholes also had to overcome the obstacle of being colored in apartheid-era South Africa. Coloreds had limited rights. However, these rights were more extensive than those granted to the blacks.

Customers would often bring old furniture they wanted refurbished to the factory and unload it without any prior conversation or approval. This effectively meant that Sithole had to warehouse these goods for their customers for free, adding to their overhead costs. Additionally, the customers would often demand that the furniture be ready so soon that overtime shifts would have to be scheduled. Ray knew that satisfying customers was the only way to remain in business.

The factory was housed in a three-story building in an undesirable area where many potential customers would refuse to come. The building, which had about 300 square meters of usable space on each floor, was condemned repeatedly by the authorities. The lighting was bad, the single elevator servicing the building sometimes got stuck and there was no parking area. However, it was the best facility they could afford, so they had to live with it.

Another facility might be possible in the future on some recently acquired land. The South African government allowed coloreds limited ownership of property in specified areas. Since it was prestigious to own property, Ray had purchased some acreage near Industria for R90,000. The terms required the purchaser to pay for the utility infrastructure plus a deposit. There would be a five-year period before the property was actually transferred and the mortgage interest rate was 28%, far above market rates. Carroll calculated that the final cost of the property, considering all these factors, at R350,000. The current market price of the land was R95,000.

One advantage the Sitholes had, though, was the family itself. They had four sons, all of whom worked for the family business. Ray felt that he could trust his sons with the business. None had college degrees, but each had worked in the business for several years, long enough to learn extensively about the craftsmanship involved in producing high quality furniture. In addition, they all shared a strong work ethic.

The company also had a strong commitment to quality. From the beginning, Ray insisted on making the best product possible and he understood that repeat customers and referrals would be important for the company's growth. Sithole's reputation for excellent quality was a great asset, and Ray never considered cut-

Exhibit 1

PRODUCTS OF SITHOLE UPHOLSTERERS

ting corners for the sake of a quick profit. Some typical products are pictured in Exhibit 1.

The eldest son, Issy, had worked in almost every functional area of the company. Carroll believed that, of all the brothers, Issy had the keenest intellect and deepest curiosity. Issy traced his strong drive and determination to see the company succeed to his stint as a delivery truck driver. He said that getting out of the factory and meeting the customer had given him a perspective that fueled his vision of the company's future. "When I was delivering furniture," Issy said, "I got to see the most spectacular houses and meet very wealthy people. It

Exhibit 2

SITHOLE UPHOLSTERERS' BALANCE SHEET
(R000s)

	1996	1995
Fixed Assets		
Land and buildings	R90	R90
Machines and equipment	1,321	1,188
Trucks	84	84
Furniture and fixtures	104	96
Less: Accumulated depreciation	(362)	(267)
Total Fixed Assets	**1,237**	**1,191**
Current Assets		
Stocks:		
Raw materials	580	523
Work in process	97	108
Finished goods	34	26
Debtors	761	517
Cash at bank and in hand	22	54
Total Current Assets	**1,494**	**1,228**
Current Liabilities		
Creditors: amounts falling due within 1 yr.	151	123
Overdraft facility	30	12
Total Current Liabilities	181	135
Net Current Assets	1,313	1,093
Total assets less current liabilities	2,550	2,284
Creditors: amounts falling due after more than one year	365	365
Net Assets	2,185	1,919
Capital and Reserves		
Called up share capital	1,000	1,000
Profit and loss account	1,185	919
Shareholders' Funds	R2,185	R1,919

Exhibit 3

SITHOLE UPHOLSTERERS' INCOME STATEMENT (R000s)

	1996	1995
Turnover	R2,712	R2,500
Operating costs	(2,161)	(1,927)
Operating income	551	573
Interest	(108)	(103)
Profit on ordinary items before taxation	443	470
Taxation on profit on ordinary items	(177)	(188)
Profit for the financial year	R266	R282

Exhibit 4

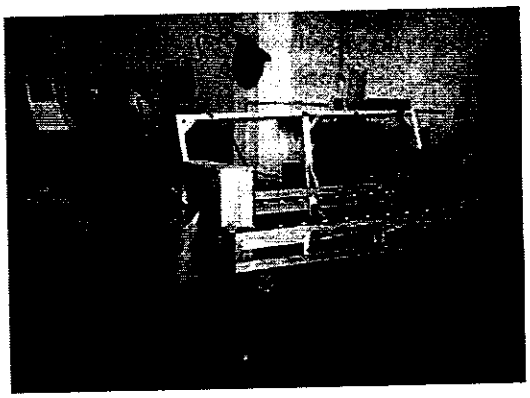
SITHOLE UPHOLSTERERS' STATEMENT OF CASH FLOWS (R000s)

	1996
Operating	
Net income	R266
Additions:	
Depreciation	95
Increase in accounts payable	46
Subtractions:	
Increase in accounts receivable	(244)
Increase in merchandise inventory	(54)
Cash flow from operations	109
Investing	
Acquisition of equipment	(141)
Financing	0
Net change in cash for year	(32)
Cash, January 1, 1996	54
Cash, December 31, 1996	22

Exhibit 5

PORTRAIT OF THE PRODUCTION PROCESS

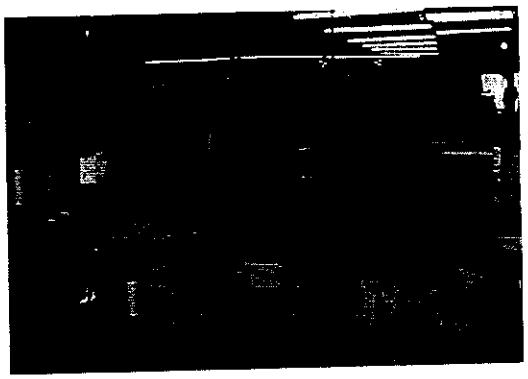
Cutting and assembling frames in the frame shop



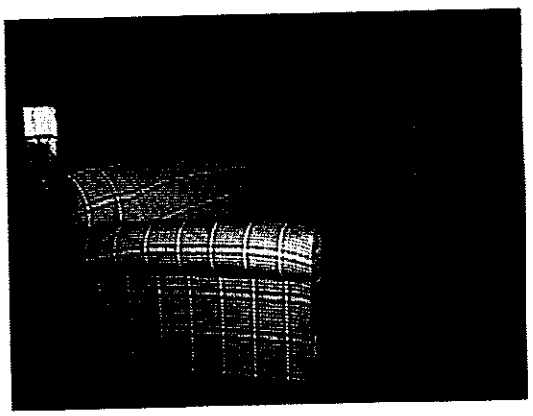
Worker fastening liner to an assembled frame

Cutting fabric at tables and storing fabric in the storeroom

Fastening fabric over foam at the upholstery station



Seamstresses sewing fabric into cushions and pillows



Putting on the finishing touches

inspired me on two levels. First, I was proud that our products featured so prominently in these lovely homes. Second, now I want one of these homes myself! Another benefit of my stint in delivery is that I know Johannesburg like the back of my hand. Now, I am able to map the delivery schedule so it is as efficient as possible and avoids congested areas when I know there will be traffic there. Also, none of our drivers can tell me it took them two hours to drive over to so and so, because I know better!"

Ray had begun the business working out of his backyard and garage. He and the rest of the family faced a lot of uncertainty, particularly in the early days of the company. Ray had worked hard and felt that it was time to take a step back and retire and let his four sons take over the business. He wanted to sell it to them for R1,000,000. They were willing to take over the company, but they didn't know whether or not the price was fair. They wanted to provide a comfortable retirement for their father, but not at the expense of bankrupting the business. Recent financial statements for the company appear in Exhibits 2, 3 and 4.

There was also the question of how the company would be managed and organized when Ray stepped aside. Issy was probably the best qualified, but his brothers had resisted taking orders from him before. Once, when Ray and his wife went on an extended vacation to Australia—a sort of trial retirement—Issy was left in charge. Whenever he made a decision or tried to implement an idea, the brothers would call their father, complaining about their tyrant sibling. Ray usually sided with the brothers against Issy and eventually returned to reassume leadership of the company. Issy was furious about what had happened and was on the verge of resigning.

Production Process

The company manufactured and refurbished lounge suites: luxury sofas, love seats and chairs. The product line was at the high-end of the furniture market, featuring superior material, design and quality. Different stages in the production process, described below, are portrayed in Exhibit 5.

The production process began in the frame building station, where boards were cut to specification and assembled into frames. A foam-cutting station and liners station cut and molded the materials that would give shape to the frame. The operator of the upholstery station used a large electric staple gun to fasten the foam and the liners to the frame.

A 35-square-meter fabric storeroom in the corner of the factory held rolls of fabric until it was needed. Because the fabrics were expensive and it was essential that they not be damaged or stolen, the storeroom was locked except when one of the fabric cutters was retrieving material.

There were six cutting tables, where the fabric was cut to fit the molded frame, now complete with foam and liner. As the fabric was very expensive, this was the most skilled position in the factory. One slip-up here could cause several square meters of fabric to be wasted.

The fabric was cut for pillows and cushions as well as for the furniture itself. Seamstresses sewed the cushions and pillows and added frills and accents as required. Another station fastened the fabric to the frame, while the cushion-filling station stuffed the pillows and cushions.

When the production process was complete, the product was inspected and wrapped in plastic. It was then either sent to dispatch for immediate delivery, or stored in the new goods storage area.

Because Sithole concentrated on making custom furniture for its interior designer customers, most production runs were in small quantities. Issy shared the role of production manager with his brother, Pierre. Pierre enjoyed the challenge of making new designs, even though that meant the furniture had to be reworked or scrapped more often. He designed about half of the patterns that the company sold, with the other brothers and their wives contributing the balance.

Pierre took a special pride in seeing one of his designs make it from the drawing board through the production process. Issy also enjoyed seeing the results of the family's creativity as well as its hard work in manufacturing. On the other hand, he would get frustrated when new designs resulted in wastage. He tried to encourage workers on the production line, particularly the fabric cutters and the frame makers, to make an extra effort to be careful when producing a new design. Ray thought that Issy's comments to the workers would slow down production, so he often told them that "time is money," reminding them that customers were waiting for their furniture.

Industry/Market Environment

Sithole sold 90% of its products to interior designers, who then resold them to their customers, often at a considerable markup. Unfortunately, Sithole felt they were at the mercy of these designers, because without them Sithole would lose crucial sales. The designers dictated price and they were frequently slow to pay Sithole.

The interior decorators would sometimes bring rough drawings of furniture to Sithole and want them to design and build the items. Usually, the decorators would specify

Exhibit 6
PRODUCTION COSTS

Name of Product		Framing	Fabric	Springs S/UP	Foam Cutting	Foam L/UP	Stitching	UPH	Cushion Filling	Total Labour Costs	Total Overhead	Total Labour & Overhead	Total Materials Costs	Total Costs
	Average Wage Rate	9.96	9.63	7.70	7.70	8.75	8.87	12.45	7.82					
Winchester Sofa	Hours to complete	3.00	2.50	0.75	0.75	1.00	4.00	4.00	2.50	18.50				
	(Cost=Hours x Wage)	29.88	24.08	5.78	5.78	8.75	35.48	49.80	19.55	179.09	414.83	593.92	785.71	1.379.63
Sherwood T Sofa	Hours to complete	3.00	3.50	0.75	0.75	1.00	4.00	4.00	2.50	19.50				
	(Cost=Hours x Wage)	29.88	33.71	5.78	5.78	8.75	35.48	49.80	19.55	188.72	436.38	625.10	785.71	1,410.81
Louw Sofa	Hours to complete	3.00	2.50	0.75	0.75	1.25	4.00	4.50	2.00	18.75				
	(Cost=Hours x Wage)	29.88	24.08	5.78	5.78	10.94	35.48	56.03	15.64	183.59	420.22	503.81	785.71	1,389.52
Lost City Sofa	Hours to complete	3.00	2.50	0.75	0.75	1.00	4.00	4.00	2.50	18.50				
	(Cost=Hours x Wage)	29.88	24.08	5.78	5.78	8.75	35.48	49.80	19.55	179.09	414.83	593.92	785.71	1.379.63
Devon Sofa	Hours to complete	3.00	2.50	0.75	0.75	1.00	4.00	4.00	2.50	18.50				
	(Cost=Hours x Wage)	29.88	24.08	5.78	5.78	8.75	35.48	49.80	19.55	179.09	414.83	593.92	785.71	1.379.63
Slipper Sofa	Hours to complete	2.50	2.00	0.75	0.75	0.75	2.50	3.00	2.50	14.75				
	(Cost=Hours x Wage)	24.90	19.26	5.78	5.78	6.56	22.18	37.35	19.55	141.35	334.02	475.37	694.19	1,169.56
Camelback Sofa	Hours to complete	3.00	2.50	0.75	1.00	1.50	3.50	4.50	2.50	19.25				
	(Cost=Hours x Wage)	29.88	24.08	5.78	7.70	13.13	31.05	56.03	19.55	187.18	431.00	618.18	700.00	1,318.18
Wingback Sofa	Hours to complete	6.00	1.50	0.75	1.00	1.50	2.00	4.50	1.50	18.75				
	(Cost=Hours x Wage)	59.76	14.45	5.78	7.70	13.13	17.74	56.03	11.73	186.30	420.22	606.52	750.00	1.356.52
Dartmore Sofa	Hours to complete	3.00	2.50	0.75	0.75	1.00	4.00	4.00	2.50	18.50				
	(Cost=Hours x Wage)	29.88	24.08	5.78	5.78	8.75	35.48	49.80	19.55	179.09	414.83	593.92	785.71	1.379.53
Knole Sofa	Hours to complete	3.50	4.00	0.50	2.00	2.00	4.00	4.50	2.00	22.50				
	(Cost=Hours x Wage)	34.86	38.52	3.85	15.40	17.50	35.48	56.03	15.64	217.28	501.03	718.31	850.00	1.568.31
Donge Sofa	Hours to complete	3.50	2.50	0.75	1.00	2.00	2.50	4.00	1.00	17.25				
	(Cost=Hours x Wage)	34.86	24.08	5.78	7.70	17.50	22.18	49.80	7.82	169.71	387.90	557.61	700.00	1,257.61
Dorchester Sofa	Hours to complete	3.50	2.50	0.75	2.00	2.50	3.00	4.00	1.50	19.75				
	(Cost=Hours x Wage)	34.86	24.08	5.78	15.40	21.88	26.61	49.80	11.73	190.13	441.77	631.90	700.00	1,331.90
Colefax Sofa	Hours to complete	3.00	2.50	0.75	0.75	1.00	4.00	4.00	2.50	18.50				
	(Cost=Hours x Wage)	29.88	24.08	5.78	5.78	8.75	35.48	49.80	19.55	179.09	414.83	593.92	785.71	1.379.63
Delta Sofa	Hours to complete	3.00	2.50	0.75	0.75	1.00	4.00	4.00	2.50	18.50				
	(Cost=Hours x Wage)	29.88	24.08	5.78	5.78	8.75	35.48	49.80	19.55	179.09	414.83	593.92	785.71	1.379.63
Modl Box Sofa	Hours to complete	3.00	3.00	0.75	1.00	1.50	4.00	3.00	2.50	18.75				
	(Cost=Hours X Wage)	29.88	28.89	5.78	7.70	13.13	35.48	37.35	19.55	177.75	420.22	597.97	685.00	1,282.97
Louw Scroll Arm Sofa	Hours to complete	3.00	2.50	0.75	0.75	1.00	4.00	4.00	2.50	18.50				
	(Cost=Hours x Wage)	29.88	24.08	5.78	5.78	8.75	35.48	49.80	19.55	179.09	414.83	593.92	785.71	1,379.63

Exhibit 7

CURRENT ORGANIZATION CHART

Sithole Upholsterers Current Structure

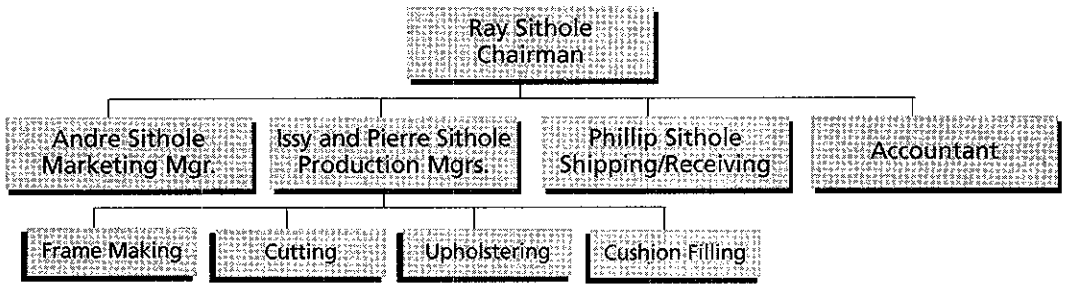
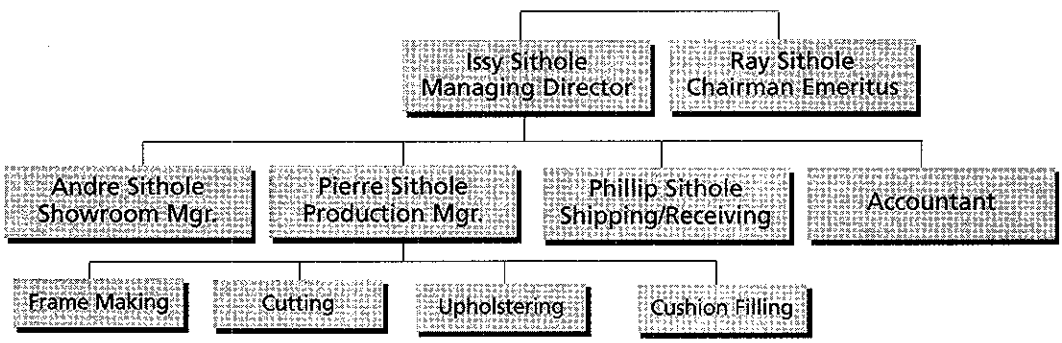


Exhibit 8

PROPOSED ORGANIZATION CHART

Sithole Upholsterers Proposed Structure



a fabric that they had in mind that matched other components of rooms in their clients' homes.

Identifying Problems

Carroll initiated a study of the production process by interviewing management and workers and by observing the factory in operation. He computed an average wage for each function on the factory floor and measured how long it took workers to complete their tasks. Based on this data, he constructed a spreadsheet of cost data that gave Sithole some information about production costs for each product (Exhibit 6). It showed clearly what products cost the most to manufacture and which were relatively cheap to make. It was the first time that Sithole had a cost-based model that they could use to set prices.

After three days at the company, Carroll related his findings to Ray, Issy and Pierre. They discussed some details of the production process and the number of workers performing some tasks. When Carroll went over the cost figures he had calculated, the Sitholes were shocked. If Carroll's figures were correct, one of their most popular items was priced R300 below cost.

One concern about production that Carroll noted was the high demand for the elevator. Since production took place on three floors, work in progress was constantly being moved from one floor to another. This caused bottlenecks, and sometimes workers were idle waiting for a frame to arrive from the frame station on another floor. The company was employing a staff of full-time movers whose only job was to push inventory from one location to the next station on the production line.

Carroll suggested that Ray call Greg Howell and schedule a meeting for the following Monday. After reviewing the way the business was run and identifying some areas that needed work, Carroll wanted to present his recommendations to the Sitholes, but felt that Howell

should be present so the Sitholes would have some idea how their banker would respond to the proposal.

Ray was moved by Carroll's findings. He concluded that the company must do a better job of developing its human resources. "One of the things we need is training-from top to bottom," he said. "We know how to make furniture as well as anybody, but at the end of the day, you have to know about the business, too. How can you be successful when you do not know these things? We thought we were doing well with the Camelback sofa, which is one of our top sellers. We did not know that each time we sold one of them, we were losing money!"

Second Meeting-Carroll's Proposal

"*Kunjani, Buti,*"[6] Carroll greeted Issy, as he arrived early for the meeting.

"That's very impressive command of the Zulu language, Ervin. However, we speak Afrikaans,[7] not Zulu." Carroll apologized for his error, but Issy assured him he was not offended and they went inside the building.

Everyone was already in the board room except Howell, who had not yet arrived. They chatted for a few minutes over tea before Howell was shown into the room. "*Howzit*[8] everyone," Howell inquired. He sat down and Ray gave Carroll the floor.

Carroll began by saying he was impressed with Sithole Upholsterers and that he had enjoyed the few days he had spent there. He praised the work ethic of the employees and the commitment of management. He had, however, identified some areas of concern. In addition to spending three days at Sithole, Carroll had talked with other people familiar with the furniture industry in South Africa, and they had given him some perspective on the environment in which Sithole operated.

The first issue that Carroll addressed was leadership. He told the Sitholes that it was common in family-owned businesses to find a lot of internal squabbling and that this could ruin a business if it got out of hand. Since Ray wanted to spend less time running the business, Carroll suggested that Ray relinquish control to Issy, who Carroll felt had the best grasp of each area of the business and who expressed a vision to improve the company's products, profitability and opportunities.

He distributed to everyone copies of the current and a proposed organizational chart, shown in Exhibits 7 and 8.

Carroll explained that if they all worked together, the situation would be best for all and that if they did not, the company might fold. Howell was nodding his head. Pierre and Andre looked agitated but said nothing.

Next, Carroll proposed that the entire company embark on a training program, which might be partially funded by the South African Furniture Industry Training Board. The workers would become more efficient on the production line, and management could receive training in business concepts such as financial controls and budgets, negotiating, accounting and operations.

An additional proposal was to open a showroom so Sithole could sell directly to the public and become better known in the marketplace. This was a serious decision not only because of the cost involved, but also because they risked damaging relationships with interior decorators who were the majority of their current customer base.

Ray interjected, "If we alienate the decorators, our sales will fall through the floor!" Carroll reminded him that the decorator took on average 90 days to pay and that they often removed the Sithole label from underneath the furniture so that their customers would identify the quality only with the decorator. He explained that a better strategy to grow their market would be to market directly to the ultimate buyers of the furniture. Also, he said, if they could market designs through a showroom and catalog, they would be able to sell more of the products they already know how to make, resulting in both larger production runs and less rejects.

Carroll then turned to Howell, who had been listening intently and asked, "What do you think, Greg? This plan may require some additional flexibility on your part, as well as some additional financing." Howell thought for a moment, then replied, "I will have to consult with the bank manager, but it's possible that we could do it. It does sound kind of risky."

Carroll continued, "What about the rest of you?" The others seemed lost in thought, except for Issy, who could barely contain his smile.

Questions for Discussion

(1) Should Sithole go forward with the plan to open a showroom? What would be the advantages and disadvantages of this strategy?

(2) How would you implement your recommendations for change? Would you recommend implementing Carroll's suggested restructuring with Issy as Managing Director? Was Carroll as effective as he could have been in the way he proposed these changes?

(3) What should Sithole do with their property? Should they remain at the same premises?

(4) Do you agree with Issy that Sithole should begin exporting their furniture? What are the implications of this strategy?

NOTES

1. This case was written by Hunter L. Moore of Texas A&M University. This case is intended as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

2. Approximately ten million South Africans are classified as "colored." They are of mixed race, usually black and white, but sometimes Indian. The South African caste system under apartheid placed coloreds below whites, but above blacks.

3. The symbol R (as in R30,000) denotes rand, the South African currency. In 1996, the exchange rate was R4.5 = US$1.

4. A *sangoma* is a witch doctor. South Africans are very superstitious and witchcraft and magic are feared and respected.

5. Afrikaners are the descendants of Dutch settlers.

6. *"Kunjani, Buti"* is a common greeting among Zulus in South Africa. Literal translation: "Hello, brother."

7. Afrikaans is the native language of the Afrikaners and coloreds in South Africa. It is derivative of the Dutch language.

8. *"Howzit"* is a slang term spoken by English and Afrikaners, short for "How's it going?"

Confederation of Zimbabwe Industries (CZI)[1]

Bulawayo, Zimbabwe

In the CZI Boardroom

After serving two years as president of the Confederation of Zimbabwe Industries (CZI), Eugene Matikiti, the first black president of CZI, knew it was a foregone conclusion that the monthly Executive Committee meeting would not end on time.[2] Several committee members, known for their tangential comments, had been brooding over the various ills facing the Zimbabwe economy: massive drought, high interest rates (above 35%), lack of a favorable government industrial policy, unfair competition from their southern neighbor ("those darn South Africans!"), etc.

"In Zimbabwe, weather is economics. If it doesn't rain this year, Bulawayo is going to become a ghost town," said one industrialist from the textile industry.[3]

"But even if we had the best rain, there's no way industry in Zimbabwe can survive without any rational government industrial policy," said another executive from the metal industry.

"Mr. Musa, can you give us a report on the current status of the business linkage initiative?" asked Matikiti.

"Thank you Mr. President," said Patrick Musa, Chairman of the Small Industries Development Committee, and one of several black entrepreneurs sitting in a boardroom full of white industrialists.[4] Musa reported on the status of the business linkage project, funded by the U.S. Agency for International Development (USAID), which was designed to encourage manufacturers to subcontract their noncore activities to SMEs (small- and medium-sized enterprises).[5]

"Since CZI conceived of this business linkage initiative, the companies in this chamber must be the first ones to implement it," Musa urged. "As you know, big industry in this country is white-owned and most SMEs are black-owned. Linkages can be seen as a potential form of indigenization or helping out the small guy."

As Musa delivered this report, Eugene Matikiti considered the potential obstacles to implementing this business linkage project: black Africans only recently gained a leadership role in CZI; industry's resistance toward indigenization; lack of trust between white-controlled industry and black-controlled government and "Rhodie" industrialists' resistance to changing elements of their businesses.[6]

Along with these attitudinal problems, Matikiti recognized that several uncontrollable circumstances made linkages difficult to achieve. These included interest rates soaring over 35%, inflation hovering around 25%, unemployment at 40%, drought and poor telephone infrastructure among other economic factors. Given these circumstances, how can this business linkage program get jump-started? What should be the private sector's role in engineering social change?

Business Linkages: Background on the CZI/USAID Project

The Confederation of Zimbabwe Industries, which called itself "The Voice of Industry," was the primary lobby group for industrialists within Zimbabwe. Its mission and aims appear in Exhibit 1. Since 1993, USAID and the CZI had conducted studies on how business

Exhibit 1

MISSION AND AIMS OF THE CZI

Newspaper article: "The CZI States Its Mission"

The Confederation of Zimbabwe Industries believes that the prosperity of the nation and the welfare of its peoples are primarily dependent upon individual initiative and endeavour. CZI champions the principle of reward for enterprise and freedom so that industry may prosper. To these ends CZI represents and actively promotes the interests of the manufacturing sector in Zimbabwe. In doing this:

- We demand of ourselves integrity, professionalism and a high level of ethical business practice. We advocate these qualities for all in the business sector.
- We influence and advise Government and those with power to effect change.
- We provide for discussion and the formulation of policy pertinent to the well-being of the manufacturing industries.
- We endeavour to anticipate and fulfill the needs of our membership body. We heed, interpret and act upon their views.
- We foster unity among our members.
- We analyse, interpret and disseminate information for the benefit of members.
- We are vigilant in the monitoring of change in the economic environment and recommending how industry may best respond.
- We encourage Zimbabwe to engage in the international business arena.
- We do all this for the benefit of our membership, manufacturing industry and for the well being of Zimbabwe and its people.

Newspaper article: "Aims and Objects of the CZI"

The Confederation of Zimbabwe Industries (CZI) is an independent, self-financed, legally constituted organisation that serves members mainly by speaking out on their behalf and generally representing their interests. The primary purpose of the organisation is to ensure that there is a viable financial and economic environment within which industry can operate effectively, prosper and contribute to national wealth and development.

Promoting a competitive, minimally regulated business environment in Zimbabwe in which sustained development is possible is a major objective. The confederation is an essential source and conduit of information about the manufacturing sector itself, the Government, potential investors and the media. It is an important source of information and advice for its members, with regular communication being directed at its members in relation to their business needs and the general business or economic environment.

Other objectives include: to promote and protect the interest of members in their endeavours to engage in profitable business; to present the views of members to, and to cooperate with and whenever possible support, the Government of the day, local authorities and any bodies associated with and essential to industry. It also seeks to collect, disseminate and make available statistics and other information on any matters concerning or affecting industry, to encourage and promote membership of the confederation and to be responsive to changes in terms of its objectives, structure and activities.

The organisation gathers and maintains information from its members on an interactive basis, with regard to matters related to industry, for subsequent translation into policies and to ensure that the organisation is adequately financed in order to operate effectively within the parameters determined by the National Council of the confederation.

Source: *The Herald*, May 31, 1996, p. C3.

linkages would assist Zimbabwe's transition toward a more market-driven economy. In general, business linkages were defined as commercial dealings between separate, profit-oriented enterprises, a phenomenon prevalent in most modern, market-oriented economies throughout the world.[7]

The CZI understood that Zimbabwe's economy was characterized by a high degree of dualism—a small number of relatively large white-controlled firms operating alongside a much larger number of black-owned SMEs. As a result of the Unilateral Declaration of Independence (UDI) between 1965 and 1980 and the subsequent sanctions against Rhodesia, Zimbabwe's manufacturers were forced to become their own suppliers by carrying out the majority of operations in-house.[8] Their operation needed goods that simply could not be imported, and they began to produce them for themselves.

The CZI business linkage project was an attempt to bridge this historical gap between industry and SMEs by creating subcontracting relationships that linked companies from one group with those of the other. Industry was now willing to explore how small local firms might supply needed goods. Since most SMEs were black-owned, linkages were seen as a way for industry to help indigenize Zimbabwe's economy. In order to appeal to industry, linkages were promoted as a way to unbundle noncore business activities and gain a positive image in the eyes of the government and the community at large. The CZI faced the challenge of creating linkages that benefitted both larger industry (the buyer) and the SME (the supplier).

The project attempted to provide four services to industry and SMEs:

(1) Matchmaking for subcontracting (linkages) between industry and SMEs.

(2) A comprehensive database of supplier SMEs and buyer industrial firms.

(3) Referral services for further training and financing to SMEs.

(4) Monitoring and evaluation of ongoing linkages.

Back in the CZI Boardroom

"We need to set this linkage project in motion," declared Patrick Musa during the Executive Committee meeting at the CZI boardroom. "CZI member companies must set an example by creating demand for subcontracting and outsourcing," he urged.

"If you can find a small guy who can more inexpensively manufacture the steel components used in the door and window frames we produce, my company would be the first in line to purchase his product. But I doubt there is anybody locally who can match our quality and our costs," said a managing director of a steel fabrication firm. "The capital equipment necessary to make the components we require is too expensive for most SMEs. Although linkages seem like a noble idea, the local chaps here lack the capital to supply us with the kind of quality product we need in large numbers."

Before Musa could respond to this criticism, a managing director of a clothing manufacturer offered another complaint. "Last year we entered into a so-called linkage with an SME to take over our button sewing operation. After several order cycles, we noticed that quality began to drop. As we looked into this problem, we discovered that the SME faced internal management problems, such as the books being in disarray, quality controls going unchecked, etc. So we sent one of our executives to this firm to help implement improved management techniques. However, we terminated this situation because it took too much effort and time on our part to improve the management of the SME."

Musa offered a thoughtful response. "In the beginning there might be several failed linkages. However, we must promote and learn from the successful ones. I urge you to see the importance of merging SMEs into the mainstream economy. With nearly half the work force out of work, unemployment represents one of the biggest challenges our economy faces. SMEs can be the engine for employment creation in this country. First, to ensure sustainable linkages, CZI will have put in place mechanisms for monitoring the quality of SMEs. Second, CZI is working alongside several small business associations and training organizations that can locate and train potential suppliers so that they can develop required capacity to link with industry."

"I have a question for you, Mr. Chairman," said a director of a firm that manufactures nonferrous metal products. "I'm not sure I like the idea of an up and coming outsider taking a look around my business and learning what took years for me to achieve. It would be asking a lot for a company like mine to open its doors to the public for the whole world to see what we do and how we do it. How do we know that these SMEs won't later grow to become our direct competitors?"

An executive committee member who usually offers criticism made an observation supporting linkages during this monthly CZI executive meeting. "In regard to our friend's last question of competition, what is preventing your current employees from starting their own businesses and thereby becoming your direct competitors? Zimbabwe no longer faces international isolation, such as during UDI. When it comes to competition, Zimbabwe is competing globally, not only with South Africa, but also with China, Southeast Asia and even Latin America."

"The notion of a supplier potentially competing directly with the buyer firm is a valid concern," emphasized Musa. "However, once a company's core business activities have been identified, that company should protect those core activities and outsource the non-core activities. Furthermore, unemployment is one of the greatest problems facing Zimbabwe today. Since IMF-driven economic reforms began five years ago, much of Zimbabwe's industry has had to retrench thousands of employees. According to Eric Bloch,[9] over 50% of the aspiring work force is without work. Consequently, many retrenchees and school-leavers have joined the informal sector or started their own businesses in order to survive, and they're barely surviving!"

"At the end of the day, the nurturing of SMEs is one of the only hopes for creating jobs. Linkages represent an ideal way for industry to use the capabilities of growing

SMEs while obtaining a favorable image in the community," concluded Musa.

When the meeting ended, Musa wondered if he had had much impact, if he had convinced his fellow industrialists of the potential value of business linkages. After most executive committee members departed, Eugene Matikiti had a brief word with Musa.

"It's critical to emphasize to these industrialists the benefits they would receive from linkages, perhaps improved public relations or government relations," Matikiti said. "However, all businesses, large and small, are simply trying to survive these days, let alone begin new linkage relationships. Let's just pray that we have good rain this year," ended Matikiti.

Weather, Economic Forecasts and the Role of Industry

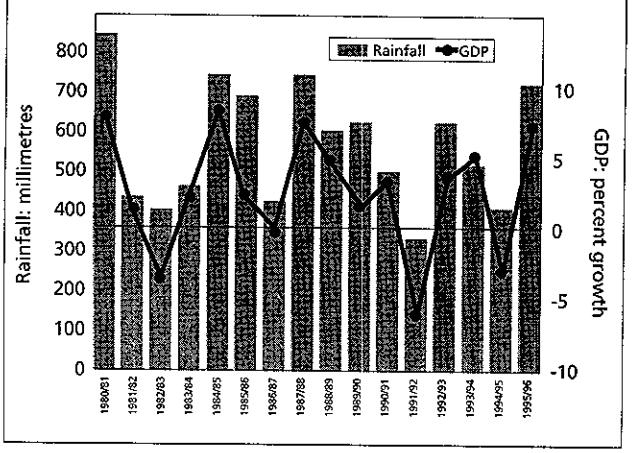
As Eugene Matikiti was attempting to phone a client in Harare from his office in Bulawayo, the heavens opened up and the rain began to pour down. The phone went dead. "These phones are useless, man. The PTC is useless!" Matikiti complained to his secretary.[10] "As soon as we get rain, which we so desperately need, the phone system collapses because it can't handle the weather! Mary, have you seen today's newspaper?"

"Here it is," said Mary, handing her boss the newspaper. "I'm afraid it won't make you any happier, though." In the *Business Herald*, a weekly supplement to the national daily newspaper, Matikiti read an article describing some of the issues facing Bulawayo manufacturers.

"Although this drought-ridden city of an estimated one million people has received above average rains, that has not been enough to cheer up gloomy corporate boardrooms where prospects of sluggish recovery and slim profits are a depressing sentiment forcing restructuring."[11]

Exhibit 2

AVERAGE ANNUAL RAINFALL VERSUS GDP GROWTH



"Well, at least we're getting some more rain right now," reflected Matikiti, unable to phone his client in Harare.

As managing director of a relatively large manufacturer and president of the Confederation of Zimbabwe Industries, Matikiti had two significant roles to play within the Bulawayo business community: one as a manufacturing executive and the other as a spokesman for local industry. At the end of his second term as president, Matikiti found himself defending industrialists in Bulawayo against allegations they were "white" economic saboteurs trying to overthrow the government. This was particularly challenging for him since he was a black man.

The following scathing lines appeared in a recent editorial in a national newspaper:

"An extremely worrying trend is emerging within the country's manufacturing industry, particularly in Bulawayo, with top white management in some manufacturing companies engaging in clandestine activities in an apparent plot which could have very serious and far-reaching consequences if the trend is not nipped in the bud . . . There can be no doubting the fact that the majority of whites whose managerial skills kept the economy going during the years of economic sanctions have never forgiven Mugabe & Co. for wrestling political power from them . . . If our reading is not far off the mark, the activities of those corporate managers concerned are not only deliberate but also calculated to have the maximum damaging effect possible on the country's politico-economic plane."[12]

Matikiti and the CZI were outraged by these outlandish generalizations made by the government-owned newspaper.

The editorial came in response to the news that nine Bulawayo manufacturers, most of them CZI members, were being investigated for illegally siphoning millions of dollars out of Zimbabwe. These companies, including several engineering firms and some manufacturers of textiles, clothing and shoes, were suspected of repatriating earnings to sister companies outside of Zimbabwe while declaring losses inside the country. One company pleaded guilty to siphoning Z$400,000 from the country, and two others went into provisional liquidation, putting hundreds of jobs at risk.[13] This industrial probing, which received much attention in the media, further eroded industry's poor relations with the government.

CZI responded to the editorial in the clearest language possible (Exhibit 3). Unfortunately, newspapers refused to publish it.

Exhibit 3

CZI RESPONSE TO INFLAMMATORY NEWSPAPER EDITORIAL

Press Release from the Matabeleland Chamber of Industries. Dated: January 17, 1996.

The Matabeleland Chamber of Industries, of CZI, as the body representing industry, objects in the strongest possible terms to the absurd contents of the Sunday news editorial of 14th January 1996. The editorial is irresponsible, defamatory, derogatory, unbalanced and totally unfounded in reality or common-sense.

Whilst we hold no brief for individual industrialists who may have contravened the law, the notion that there is a "well-orchestrated" plot to sabotage the economy is preposterous. That editorial has implied that all the well-known economic difficulties facing industry nation-wide do not exist. Instead the editor maintains that industry's problems are caused by a conspiracy of deliberate "economic sabotage", causing the companies to fold up. This is alleged to be a deliberate policy to retrench labour, provoking political instability and counter revolution!

This level of journalism is not worthy of a national paper or of a national press owned by the government. This is an insult to the mentality of all readers and the public at large.

The real problems which industry faces are:

- crippling interest rates
- shrinking consumer buying power
- lack of satisfactory trade agreement with our largest trading partner
- skewed tariffs against industrial inputs
- excessive Government spending which is fueling inflation

The editorial ignores all these facts and those responsible for the situation, and would like the uninitiated reader to believe that the problems are actually caused by the industrialists themselves!

This editorial is a serious distortion of the facts. Perhaps the editor feels that if the lie is big enough he will get away with it. The tragedy is that we cannot even begin to turn the economy around whilst those with the power to enlighten the public act in such an irresponsible manner. The public should ask itself who in fact is destroying the economy.

Establishing a Business Linkage

CZI members understood that the business linkage program could counter such false accusations by demonstrating industry's interest in improving the local economy and creating opportunities for smaller businesses. Linkages to date, however, had met with difficulties. Assuring quality of production was a major concern.

Still, some CZI members were moved by Patrick Musa's speech and were willing to explore possible linkages. Musa was approached by Ian Lander, Chairman of Highveld Textiles, to discuss a potential linkage for ZimWeave. ZimWeave, a company within the Highveld Textiles group of companies, was the country's largest manufacturer of blankets.

Ian Lander, an Englishman in his late 50s, had started working in the textile industry in Great Britain at the age of 15. By the time he was in his 20s he had been

Exhibit 4

BUSINESS LINKAGE PROJECT SUFFERS SETBACK

Newspaper article: "CZI Project for Small Businesses Suffers Setback"

The small industries development project recently launched by the Confederation of Zimbabwe Industries (CZI) to facilitate the subcontracting between large–and medium–scale industries has suffered a setback following the liquidation of numerous manufacturing giants in Bulawayo.

Matabeleland Chamber of Industries president, Eugene Matikiti, said the project, although still on course, has been adversely affected by the closure of Bulawayo companies that were major players in the proposal. "The liquidation of G & D Shoes has been a major setback to the linkages programme because the company was very much involved in subcontracting some of its functions to up-and-coming small companies," he said.

The Tirzah Investment Group management—owners of the beleaguered G & D Shoes (Pvt) Ltd. now under provisional liquidation—cited lack of export incentives and high interest rates as some of the reasons that forced them to seek a voluntary provisional liquidation order to protect their creditors. A joint ZRP Fraud Squad and National Economic Conduct Inspectorate team is investigating G & D Shoes and Zeco (under final liquidation), National Blankets and Merlin Ltd.

Matikiti said more than 90 large and medium-scale companies had registered for the United States Agency for International Development-backed project. He said some of the funds from the two-year USAID grant had started pouring in and a director for the project would be appointed this month. The project, to be centered in Harare and Bulawayo, would initially involve the establishment of a search/brokerage facility whereby large-scale industries would be matched with appropriate small enterprises.

Matikiti said most Zimbabwean companies were taking steps towards registering with the International Standards Organisation (ISO). Many companies were, however, finding this an expensive exercise, especially given the current economic hardships bedevilling many manufacturing plants in the city. "The whole exercise involves engaging consultants and auditors from overseas or South Africa every six months or so, and this could run up to half a million dollars or more," he said.

Reprinted from *Financial Gazette*, February 8, 1996.

transferred to Africa, where he has stayed ever since, advancing over the years to the top of one of Zimbabwe's largest textile firms.

The textile industry in Zimbabwe was fighting a negative image throughout the country. The industry experienced massive retrenchments (layoffs) following the bankruptcy of several firms. Several other textile firms were involved in the alleged plot to sabotage Zimbabwe's economy, mentioned in the editorial above.

"As you know, the textile industry in general and ZimWeave in particular not only have been fighting to survive financially, but also to overcome a negative public relations image. The closure of several firms, massive retrenchments and suspicions of economic sabotage by ZimWeave have severely damaged the image of the textile industry in Zimbabwe," said Lander.

"A couple of years ago, ZimWeave upgraded its fleet of box and plain looms. To this day, the old looms, purchased over 30 years ago, are still sitting idle on the factory floor collecting dust. There are over 30 of these moth-balled looms taking up valuable floor space," continued Lander. "Now, it would be very simple to sell the looms for scrap cast iron just to get rid of them. However, that would be a terrible waste of equipment which could easily be resurrected with the intention of establishing a new business enterprise."

"Instead of just throwing away these old looms, they could be sold to an entrepreneur at scrap value and then reconditioned. ZimWeave would consider entering into an outsourcing arrangement with the entrepreneur. During periods of increased demand, ZimWeave would provide raw materials to the new enterprise and would purchase the output as completed woven blanket stock."

"As far as staffing goes, there are plenty of ZimWeave retrenchees available with the qualifications to operate and maintain the looms. Each loom produces approximately 100 blankets per week based on a 40 hour week."

Musa, who could see the potential of this linkage, asked himself a series of questions. "What is motivating Lander and Highveld Textiles to pursue such a linkage? Would this outsourcing relationship improve ZimWeave's production output? Would this linkage be profitable for both sides? Is it true that these old dusty looms can actually be restored to working condition? Is this linkage opportunity mainly a PR maneuver for ZimWeave?"

"If you think CZI could facilitate creating a new business that utilizes ZimWeave's old looms, please make an appointment with ZimWeave's acting managing director Jack Smith," concluded Lander.

Meeting with ZimWeave's Managing Director Smith

While waiting outside Smith's office at ZimWeave, Musa considered the growth potential of this loom linkage venture. This new enterprise could receive a jump-start from ZimWeave by temporarily offering a guaranteed market, at least for the first few months or a year. The looms could then be reconfigured to manufacture an altogether different product line than ZimWeave's. One operator per loom together with management and an administrative staff would provide several dozen jobs. From ZimWeave's perspective, this linkage represents a way to gain some political kudos and improve the tarnished image of the textile industry.

As Musa was organizing his thoughts for the meeting, a secretary led Musa into Smith's office. "As I mentioned to you on the phone," Musa began, "Mr. Lander suggested the possibility of reviving ZimWeave's old looms with the aim of creating a new business entity. I would like to discuss ways in which CZI could assist in coming up with a win-win proposal for both ZimWeave and the newly formed SME. For convenience sake, let's call this SME 'OLE,' short for Old Loom Enterprise."

Smith replied, "Let me begin by saying, actually, that I am disappointed in your enthusiasm." Musa was shocked and confused. Smith continued, "I think this initiative is doomed to be a non-starter if some basic logistical issues are not covered. You would have to ensure that quality standards would be met; we would require that all payments be made in cash; you would have to locate adequate premises and employees; you would have to source your own financing; it would cost ZimWeave a lot of time and money to maintain the looms on a regular basis . . . " This formidable list of barriers threw Musa slightly off guard. However, Musa remembered that Smith was an accountant by training, not someone who has devoted his whole career to the textile industry, like Lander.

"Furthermore, if we establish an ongoing outsourcing relationship with this so-called OLE outfit, ZimWeave could face some liability problems if the relationship goes sour. Assuming that the looms would be operated by a group of black employees, we don't want to be accused of racism if we have to terminate the relationship as a result of OLE not producing quality products or not paying its bills on time," warned Smith.

"I agree that we must identify all the possible pitfalls so that we can prevent them from happening," Musa responded. "CZI is interested in facilitating linkages that are mutually successful. In this loom linkage, ZimWeave would regain much needed factory floor space while earning some positive PR for enabling some 'little guys' to start their own business."

"That sounds nice on paper, but you must sort out the logistical issues in order for ZimWeave to enter into any kind of linkage. My board of directors is probably very keen on this linkage because ZANU-PF,[14] which holds 50% of the shares in ZimWeave, would look favorably upon it as a way for the company to engage in some form of indigenization," said Smith.

"If you want this project to be a success, I suggest you contact someone named Andrew Williamson," advised Smith. "Andrew, who retired as production manager a few years ago, was with ZimWeave for nearly 40 years. He knows these looms inside and out. He would never allow himself to be associated with any substandard weaving operation. Although you might find him difficult to deal with, he's your man if you want quality. To this day, Andrew is the most qualified loom expert in Zimbabwe. He is the most brilliant machinist and craftsman in the textile weaving industry in Bulawayo, if not the whole country. In fact, this man's life was his job when he worked here. If you have good people skills and are able to deal with Andrew's rough edges, he will be the one who can make this linkage fly."

Encounter with Former ZimWeave Production Manager Williamson

Before meeting Williamson, Musa had prepared his mental list of all the reasons why Williamson should want to get involved in this venture: Williamson could have a great deal of control over operations, he could earn more income to supplement his pension and he could rediscover his passion for textile looms. Assuming that Williamson would be hard to convince, Musa wanted to make this proposal as attractive as possible.

After exchanging pleasantries with Williamson, Musa explained the potential loom linkage with ZimWeave. He described the subcontracting arrangement, the potential of developing a new product line, and the combination of both outsourcing and new product development. Since Williamson came highly recommended by ZimWeave, Musa offered him a leading managerial role in this linkage.

"So, do you think this loom linkage is feasible, and would you like to be involved in organizing it?" asked Musa diplomatically.

"Hell, yes!" Williamson answered immediately. "ZimWeave doesn't know what the hell it's doing these days, especially with Smith. Since I left four years ago, that place has gone downhill. I know those looms blindfolded. I got those looms up and running when ZimWeave bought them for £150 each from England 30 years ago. It's beyond me why they wanted to replace those perfectly good looms. To tell you the truth, I think we'll be able to show ZimWeave a thing or two."

Musa was very encouraged by Williamson's response and was amazed at how easy it was to gain Williamson's interest in the project.

"Who is behind this deal, anyway?" asked Williamson.

"Ian Lander approached me, originally," replied Musa.

"That's a very good sign," Williamson added.

After this encounter with Williamson, Musa pondered what made Williamson so eager to get involved in this potential linkage. Was he bored since retiring four years ago? Was he interested because his ego was stroked? Did he simply want to make a little extra money? Did Williamson hold a grudge against ZimWeave management? Did he want to compete head to head with ZimWeave?

Musa and Matikiti, Back at the CZI

In preparation for a follow-up meeting with ZimWeave, Musa told Matikiti about his encounters with Smith and Williamson.

"Smith definitely seemed a bit resistant to creating this linkage," Musa said to Matikiti. "I know you were trained as an accountant, so please don't take offense at what I'm about to say. But Smith seemed to be the stereotypical conservative accountant who only cares about money. He focused on the problems of the linkage and gave very little impression that he wanted to see it take place."

"No offense taken, Patrick. Personally, I don't consider myself simply an accountant. Rather, I strive to be a business leader who can tackle any number of business issues," bragged Matikiti. "But enough about myself. How about this Williamson character? He seems like just the bloke who can get this linkage airborne."

"Yes, even though I was warned that he could be somewhat gruff, when I met with him, I found him to be quite agreeable," answered Musa. "However, there is a downside to making him a key player in this deal. We have to ensure that Williamson trains the staff effectively. Otherwise, when he leaves, the linkage collapses. Without sustainability, it won't work."

"This linkage demands Williamson and ZimWeave do some 'buyer mentoring' to the SME. Without proper training, this linkage will falter and never be sustainable. Also, Smith is correct about the need to work out the logistics," added Matikiti. "Williamson's expertise and mechanical know how will make the linkage credible, especially since he comes so highly recommended by ZimWeave. Since Ian Lander approached you, Smith will probably have to agree to whatever Lander and the board decide."

"For now, we must come to some basic terms on the

parameters of this linkage. As soon as possible we should have a meeting together with Lander, Smith and Williamson in order to get the ball rolling," suggested Matikiti.

Discussion at the ZimWeave Boardroom

Waiting in the ZimWeave boardroom, Matikiti thought about the number of meetings it had taken simply to get to this point in negotiating an actual linkage. "Let's make sure something tangible comes from this meeting," said Matikiti to Musa.

After Williamson and Smith arrived, Lander began the meeting with the intensity of a rugby coach giving a pep talk minutes before a match. "It's time for us to make this project a reality," Lander declared. "I see OLE outsourcing for ZimWeave during periods of peak demand. During the low seasons, OLE would be free to develop its own product line. After our discussions today, I'm going to expect a proposal coming soon from the CZI."

Matikiti was very pleased with the way this meeting was proceeding. "I envision ZimWeave supplying raw material to OLE for blanket production outsourcing," responded Matikiti. "The tonnage of finished product would have to conform to ZimWeave's standard ratio of finished product to waste; since the waste is reusable, OLE would be required to give back all waste to ZimWeave. This would serve as a control mechanism since the weight of both the product and waste should equal the original raw material weight. Such a system would ensure that OLE does not squander the raw material and should help to alleviate unnecessary cash flow burdens between both companies."

When Matikiti concluded, he noticed Smith shaking his head in disapproval. "Originally, we were simply going to scrap these looms and therefore eliminate any potential liability," said Smith. "I would rather just get rid of them and have nothing more to do with them. In fact, I met with someone from Zambia who is interested in purchasing them. This represents the best option."

"Well, I can't stop you from selling to Zambia,"said Matikiti.

"You are in the best position to tell us about the looms, Andrew," said Lander. "What kind of shape are they in?"

"Ach, they're bloody good machines, but they've been sitting idle for years," said Williamson. "Consequently, some of the parts may have been cannibalized. It would be a tragedy to see them continue in this state."

Lander had a suggestion which would get this linkage out of debate and into action. "Let's begin with a three-month pilot scheme using six looms in a direct outsourcing relationship with ZimWeave. If it works, the linkage could be expanded to include more looms and continue on a larger scale. If it doesn't work, we can just write it off as an experiment and sell the looms to Zambia."

NOTES

1. This case was written by Ken Meagor of Monterey Institute of Management. It is intended as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

2. Eugene Matikiti was managing director of Zimbabwe Grain Bag, a manufacturer of polypropylene woven bags which employed over 600 people. Matikiti, an accountant by training, was respected as a leader by both the white and black business communities in Zimbabwe.

3. Bulawayo was the second largest city in Zimbabwe, after the capital Harare. Estimates indicated that Bulawayo, which had been suffering from recurrent drought since 1992, had less than a year's supply of water.

4. Patrick Musa was the owner of Pith Helmet Industries, a company of about 70 employees that manufactured various hats, t-shirts and curios for export and domestic consumption. In the last several years, CZI had made efforts to recruit black entrepreneurs into its leadership ranks.

5. In November 1995 CZI and USAID launched a business linkage project going under the name Zimbabwe Enterprise Development Programme (ZEDP). USAID established a grant to CZI for roughly US$280,000 to fund ZEDP for a three-year period.

6. "Rhodie" was a term sometimes assigned to whites, usually born in Rhodesia, who still cling to colonial values. They are reluctant to embrace the local cultures of Zimbabwe and are resistant to indigenization.

7. Mead, Donald C. and Kunjeku, Peter, *Business Linkages and Enterprise Development in Zimbabwe*, 1993.

8. In 1965, Ian Smith declared Rhodesia's independence from Great Britain. In protest of Smith's white-controlled government, the international community imposed sanctions against Rhodesia. After a civil war that ended in 1980, Rhodesia became Zimbabwe under the leadership of Robert Mugabe.

9. Eric Bloch, a well-known economist in Zimbabwe, was a columnist for the weekly *Financial Gazette*. In his column of April 25, 1996, he wrote that more than 2.6 million job-seekers are unemployed; 300,000 school-leavers enter the job market every year; and those exiting employment by retirement, death or self-employment are estimated not to exceed 50,000. Mr. Bloch held seats on the boards of several companies and lived in Bulawayo.

10. The Postal and Telecommunication Corporation (PTC) is a parastatal which controls and operates Zimbabwe's postal and telecommunications services. According to the 1994 International Telecommunications Union report, Zimbabwe's teledensity—the number of telephone lines per 100 inhabitants—is 1.3%. According to the 1996-1997 CZI Buyers' Guide, in 1996 there were an estimated 290,000 phone lines available for a population of roughly 11 million. The PTC had acknowledged that more than 100,000 people were on its waiting list for telephones, many of whom have been on the list for the past five years. According to a Zimbabwe Investment Center study, commissioned by the World Bank, investors singled out telecommunications as one of their major worries for doing

business in Zimbabwe (*The Herald*, May 17, 1996; *The Financial Gazette*, May 23, 1996).

11. Basutu, Abel, *The Bulawayo Chronicle*, February 1, 1996.

12. *The Sunday News, Commentary*, January 14, 1996.

13. *The Business Herald*, Local News, January 25, 1996. (At this time the exchange rate was approximately 9.5 $Zim to 1US$).

14. ZANU-PF (Zimbabwe African National Union-Patriotic Front), with President Mugabe as First Secretary, was the ruling party in Zimbabwe. Out of 164 Members of Parliament, only three were not ZANU-PF.

ETM Enterprises (Pvt.) Ltd.[1,2]

Harare, Zimbabwe

As the sun rose, filling the clear morning sky with a pink glow, the security guard at the Zimbabwe Commercial Bank (ZCB) said *mangwanani*[3] to Nyasha Murewa,[4,5] the bank's new director of community and small business lending. Hardly a good morning, Nyasha thought to herself, as she glanced at her watch and realized that she was late once again due to a Harare traffic jam. Hoping to save a few minutes in the building, she dashed to the elevator but found it out of service, bearing the usual "closed for routine repairs" sign. Climbing five flights of stairs to her office, Nyasha wondered if the lights now worked after yesterday's power outage. As she flipped the switch and the lights went on, she saw a note on her desk left that morning by Edwin Chakanesta,[6] the head of the loan division. "Nyasha, expect to see you tomorrow, 9 a.m., 9th floor conference room for the loan meeting. Plan to discuss whom you selected, what criteria you used for evaluation and what terms to offer."

"I sure hope the elevators are back in operation by tomorrow," thought Nyasha, and she hung up her coat, looked over the morning paper and poured herself a cup of tea. She knew she had a busy day ahead of her. She needed to finalize her recommendations for ZCB's new small business loan program. Traditionally just a lender to larger industry, the bank recently decided to offer loans to small businesses to create opportunities for indigenous people.

Nyasha had tentatively decided ETM Enterprises would be the first small business recipient of a ZCB loan.[7] ETM, a medium-sized, family-run, nonagricultural business, Nyasha reasoned, was the type of borrower that was critical to the bank's long-term success.[8] Eustina and Tawanda Madunhurirwa,[9] ETM's managing director and chief operations–finance manager, respectively, operated a passenger transport business[10] and sold chickens along with various crops (e.g., maize (corn), beans, onions, carrots, tomatoes, lettuce and potatoes). In addition to these small businesses, Eustina was the director of Zimbabwe's University library, while Tawanda was a tenured professor with an endowed chair in geology and environmental science. He also served as a department chair. They were seeking a loan to expand their transport business.

Although Nyasha had confidence in ETM's management, she nonetheless wondered how the businesses would proceed. No projected balance sheet or profit and loss statement were included in the loan application.[11] Nyasha recalled first discussing ZCB's new loan program with Eustina and Tawanda about six months ago at church.[12] When the loan program became operational, Nyasha formally visited Eustina and Tawanda to tell them about the scheme, learn more about their businesses and better understand the size and purpose of the proposed capital expenditures they planned to undertake with the loan.

The Month in Review

After church that day, Nyasha accompanied Eustina to her house, where they prepared tea and snacks and talked about the weather, specifically the drought.

After several months of no rain, the crops were wilting and agricultural yields were down. The hope that their garden would make them self-sufficient while providing extra saleable produce had quickly withered. Their considerable praying was answered when the heavens opened up with a deluge. It rained for most of the month, almost without stopping. Many crops began to mold. Those that did not mold, such as maize, tipped over because of shallow roots. Eustina and her staff then spent several days propping up this basic food.

As the rain continued, several of the neighbor's pine trees toppled. One nearly missed the chicken coop, while another one knocked out the power and telephone lines. It was a holiday weekend, and the weather delayed the repair crews, leaving ETM in the dark and without telephone service for nearly four days.[13]

Weather was only part of the month's concerns. Basic food commodities (e.g., flour, sugar, milk, maize meal) had risen in price by 20% that year, after a 25% increase the previous year. Petrol (regular auto gasoline) prices increased 10% with an additional 7-9% price rise expected. Postage and telephone rates jumped approximately 25%, while license fees for owning televisions and radios rose to Z$200 from Z$120 just a year earlier, and newspaper prices increased to Z$2.00 from Z$1.50.

As the month end neared, Eustina and Tawanda learned that their university salaries were rising only 15%, less than the rate of inflation,[14] not the 26% initially indicated.

The loan application focused on business information, in particular their plans for expanding their passenger transport business. Clearly this was one part of their business portfolio that could flourish in heavy rains.

Other Matters of Family Concern

ETM's concerns extended beyond drought, power outages and price increases. They further included budgeting for upcoming family educational costs. Tawanda and Eustina believed university education in the United States for their four children was essential. The children were fluent in English and accustomed to American teaching methods. During Eustina and Tawanda's sabbatical in the United States, the children enrolled at public school and received outstanding marks. Two of their children had already earned U.S. bachelor's degrees and were attending graduate school, one in law and the other in medicine. The older children had received substantial scholarships, and relatives in the United States paid the difference. The third child also had completed his bachelor's degree and was awaiting acceptance letters and teaching assistant notification from U.S. public health programs. Their youngest, in her final year of high school, would take her university placement exams soon. She had scored exceptionally well on the TOEFL (Test of English as a Foreign Language) exam and during the family's sabbatical had taken the PSAT (Preliminary Scholastic Aptitude Test), receiving a score of national merit. However, while they had many friends and relatives in the United States, Eustina and Tawanda both knew university fees there were substantial and continually increasing.

Eustina and Tawanda owned a five-bedroom house in Harare's northwest suburbs. They were actively involved with their church and served on the board at their daughter's school while routinely hosting American students studying in Zimbabwe. However, their home was also a refuge for many "cousins" in poor health, financial difficulty or need of extra encouragement or support.[15] They currently had one "older" cousin living with them, who was seriously sick, apparently with AIDS.[16] Medication costs were increasing, and they wondered how long the pain and suffering would last.

Back at the Bank: Processing ETM's Loan Application

ETM wanted to expand and update its combi fleet (passenger vans) with the purchase of three additional vehicles, but lacked enough working capital, Nyasha recalled. She wondered if the amount requested (Z$500,000) was appropriate, and whether the planned used vehicles were the best choices. She made two notes to herself: (1) If the combi business failed, would ETM seek funds for its other businesses? (2) Why purchase three additional vehicles rather than two? ETM wanted to purchase a 16-passenger 1985 Toyota Townace, a 16-passenger 1987 Toyota Masterace and a 17-passenger 1990 Toyota Hiace. Given vehicle costs and anticipated revenues, were these optimal choices? ETM believed that Z$500,000 was required to cover the purchase and initial maintenance costs. Was this an appropriate amount? Were the planned vehicles the best choices? If ETM did receive the loan, could they repay the estimated Z$23,200 monthly loan payment? Nyasha added these questions to her list. Since interest, inflation and unemployment rates were important indicators, Nyasha reviewed the Zimbabwe background material on the economy (see Appendix) to weigh their likely impact on ETM projections.

Normally, a loan assessment involves the review of key documents such as a statement of cash flow, balance sheet and income statement, or a full business plan. Unfortunately, ETM had none of these. However, since Nyasha knew ETM personally, she understood their major expense categories, number of vehicles owned, staff size and combi fares. From this basic information, Nyasha drafted an income and expense sheet that examined financial results biannually. See Exhibit 1.

But questions remained:

- How accurate was the drafted income and expense statement?
- Were revenues inflated?
- Were appropriate rates used to project income and expenses?
- During difficult economic times, fares were discounted; how were these tracked?
- Were operating cost assumptions accurate?

Thinking further about these questions, Nyasha found herself in a bit of a quandary. She really wanted to help ETM. Eustina and Tawanda were her cousins, and she knew how a ZCB loan would benefit ETM. On the other

Exhibit 1

ETM INCOME AND EXPENSES (ALL PRICES IN ZIM$)

		1989	1990	1991	1992	1993	1994	1995	1996	1997 (est.)
INCOME										
12 pass, 1984 Toyota Hiace	Vehicle 1	105,840	127,008	196,560	187,425	199,063	240,570	158,400	272,250	292,500
15 pass, 1984 Toyota Hiace	Vehicle 2		158,760	241,920	232,407	245,000	311,850	201,600	346,500	380,250
16 pass, 1984 Toyota Townace	Vehicle 3				247,401	260,313	332,640	216,000	371,250	438,750
16 pass, 1985 Toyota Masterace	Vehicle 4						353,430	230,400	396,000	438,750
Total Income		**105,840**	**285,768**	**438,480**	**667,233**	**704,375**	**1,238,490**	**806,400**	**1,386,000**	**1,550,250**
EXPENSES										
Vehicle Purchases	Vehicle 1	60,000								
	Vehicle 2		68,275							
	Vehicle 3				86,737					
	Vehicle 4						115,200			
Total: Vehicle Purchases		**60,000**	**68,275**	**0**	**86,737**	**0**	**115,200**	**0**	**0**	**0**
Salaries	Drivers	4,850	11,252	13,277	25,767	30,791	51,100	60,000	70,800	83,544
	Conductors	3,200	7,424	8,760	17,185	20,537	34,270	40,800	48,144	56,810
	Bonus		1,000	1,500	3,000	3,800	6,600	8,400	9,912	11,696
Total: Salaries		**8,050**	**19,676**	**23,538**	**45,952**	**55,128**	**91,970**	**109,200**	**128,856**	**152,050**
Insurance	Vehicle 1	1,918	2,283	2,718	3,236	3,853	4,586	5,460	6,500	7,670
	Vehicle 2		2,283	2,718	3,236	3,853	4,586	5,460	6,500	7,670
	Vehicle 3				3,236	3,853	4,586	5,460	6,500	7,670
	Vehicle 4						4,586	5,460	6,500	7,670
Total: Insurance		**1,918**	**4,567**	**5,437**	**9,708**	**11,558**	**18,346**	**21,840**	**26,000**	**30,680**
Petrol and Service	Vehicle 1	184,464	184,648	184,833	185,018	185,203	185,389	185,574	185,760	185,946
	Vehicle 2		184,648	184,833	185,018	185,203	185,389	185,574	185,760	185,946
	Vehicle 3				206,532	206,739	206,945	207,153	207,360	207,567
	Vehicle 4						206,945	207,153	207,360	207,567
Total: Fuel and Service		**184,464**	**369,296**	**369,666**	**576,568**	**577,145**	**784,668**	**785,454**	**786,240**	**787,026**
Route Application	Vehicle 1	500	580	670	780	900	1,050	1,200	1,400	1,600
	Vehicle 2		580	670	780	900	1,050	1,200	1,400	1,600
	Vehicle 3				780	900	1,050	1,200	1,400	1,600
	Vehicle 4						1,050	1,200	1,400	1,600
Total: Route Application		**500**	**1,160**	**1,340**	**2,340**	**2,700**	**4,200**	**4,800**	**5,600**	**6,400**
License and Registration	Vehicle 1	118	141	167	199	237	282	336	400	464
	Vehicle 2		141	167	199	237	282	336	400	464
	Vehicle 3				199	237	282	336	400	464
	Vehicle 4						282	336	400	464
Total: License and Registration		**118**	**281**	**335**	**597**	**711**	**1,129**	**1,344**	**1,600**	**1,856**
Total Expenses		**255,050**	**463,255**	**400,315**	**721,903**	**647,242**	**1,015,513**	**922,638**	**948,296**	**978,012**
NET (income-expenses)		**-149,210**	**-177,487**	**38,165**	**-54,670**	**57,133**	**222,977**	**-116,238**	**437,704**	**572,238**

hand, she realized ETM did not formally track financial transactions. In fact, ETM's cash and budgeting controls were unclear if at all existent. For example:

- How did ETM verify revenue collection versus actual ridership?
- Were expenses paid from daily takings (cash) or centralized payment (checks)?
- How were fuel purchases and vehicle service (repair) records validated?
- What about lost revenues due to vehicle downtime and traffic congestion?
- Did license and insurance fees vary across vehicle size and weight?
- What vehicle purchase records existed (i.e., date purchased, passenger size, fuel type)?
- What about vehicle use outside daily passenger transport (i.e., for driver's personal use)?

She tried to balance these concerns with wondering how best to persuade Edwin and the loan committee. Maybe a few hours talking with Eustina and Tawanda about the combi business, helping them formalize their income and expense records, and reviewing existing control mechanisms and designing new ones would help. Such a meeting would enable ETM to reduce her uncertainty and provide greater documentation for the loan committee. She would call ETM that afternoon to set up an urgent meeting that night.

The Origins of ETM Enterprises

Eustina and Tawanda founded ETM Enterprises following their sabbatical leave to the United States. Although Eustina and Tawanda held tenured university positions, they needed to augment their incomes. This was essential because the Zimbabwe economy had continued to decline.[17] Several business options entered ETM's minds. They could get involved in selling garden produce, chickens and eggs, or making fancy cakes and pastries.[18] These were simple businesses, with low barriers to entry and potentially small yet steady income streams. On the other hand, the passenger commuter service market had substantially more revenue potential compared to these other businesses. But running this business was quite another matter. Their teaching obligations, research responsibilities and family commitments prevented them from handling day-to-day business matters. Employees would be needed to do that. Whatever they pursued, ETM's chosen businesses had to generate consistent income flows with few unpredictable costs.

ETM's transport business currently employed seven full-time and numerous parttime employees. Employee education levels varied from high school to some university. ETM believed that their relationship with an employee's family was as important as the employee's work history. Tawanda and Eustina knew many of their employees since birth, and employee tenure averaged 9-11 years. As a result, Eustina and Tawanda felt tremendous confidence and trust in their employees. Prior to starting a new employee, Eustina and Tawanda had their current staff meet and talk with prospective hires. ETM also ensured all drivers were licensed as commercial drivers, and the local automobile association (AA) certified their driving records. All ETM drivers had AA ratings of 8.5 or better.[19]

The Passenger Commuter Industry

Eustina and Tawanda saw clear trends that made the passenger transport business promising:

- Lack of reliable public (government) urban transport (ZUPCO buses)[20]
- Distance of employee residences from the city center[21]
- Limited quantity and high cost of privately-owned vehicles[22]

In ETM's eyes, people were in a hurry. They were tired of waiting for a ZUPCO bus that would likely never come and wanted something better. So before long, "emergency" taxis (ETs) or "pirate" taxis appeared on the streets. These were often old Peugeot 404 station wagons[23] held together with tape, wire and cloth. Although engine performance and appearance were questionable, ETs ran routinely from the high density suburbs to the city, charging a fixed rate, stopping anywhere and everywhere in between. They were only slightly more expensive than ZUPCO.

Even though a commission regulated emergency taxis and passenger commuters, only a few rigid rules were on the books. For instance, rules addressed vehicle condition, road worthiness and registration. Owners registered for specific routes to avoid area saturation or neglect. After the owners selected a route, the commission assigned starting and ending points—usually starting in the suburbs and ending in the city center. Individual operators decided all other matters such as rates, pickup and dropoff points along the routes and hours of operation. Beginning in 1989, the original ET operators encountered substantial pressure from minivans and larger combis, which operated in the same manner as ETs but carried more passengers.

ETM and the Passenger Commuter Industry

Eustina and Tawanda easily converted their old family

supply van into a passenger van. With a bit of seat construction, they were ready to operate. A close friend from church who had been recently retrenched (fired) agreed to work as a driver for a flat monthly salary. ETM then received its first route.

The combi business did well, netting between Z$850-Z$1,250 per day using four vehicles. With these profits ETM purchased other secondhand combi vehicles from auctions or by word-of-mouth. The business looked promising. As one ETM driver explained, "[It's a] shame, about the only passengers left for ZUPCO [to transport] are children attending government schools . . . and they [ZUPCO] cannot even do this very well."

If a potential vehicle was in poor condition, friends of Eustina and Tawanda from the church or the university would repair, repaint and have the ETM vehicle on the road quickly. However, as competition grew, it became harder to find inexpensive secondhand vehicles. The combi business was making money, and ETM wanted to expand, but they now needed vehicles purchased on the "commercial" market where costs were a concern. ETM also wondered how to enhance their revenue stream through other salary and wage packages (e.g., paying an incentive to the driver and the assistant based on number of passengers carried, total revenue generated or a percentage of daily earnings).

ETM's fleet of commuter transit vehicles

ETM believed it had a good thing in the combi business, and the business should grow by adding more vehicles. "It's all based upon passenger turnover, and as long as cars remain expensive and people continue working in the city center, we will be successful," Tawanda said. Currently, passenger commuters were charged Z$2.50 for one-way travel, about Z$.50 more than ZUPCO. Exhibit 2 shows Anticipated Combi Vehicle Revenues.

In terms of operating expenses, Eustina and Tawanda estimated that combi fares rose about Z$.50 a year, and 14-17 passenger combis were the optimum size. Although these larger vehicles cost more to purchase and operate than the smaller seven-to-ten-passenger models, obtaining greater financial return was possible given the same fixed costs of driver, petrol, insurance and registration. However, vehicles larger than 17 passengers were not advantageous because they required more passengers and greater waiting time before beginning their return trip. Consequently, these very large vehicles had lower passenger-per-day revenue streams.

Exhibit 2

ANTICIPATED COMBI VEHICLE REVENUES (ALL PRICES IN ZIM$)

Number of passengers/trip		12	13	14	15	16	17
Assumptions: Combi makes 3 trips/hour; operates for 12 hours/day, 300 days/year		300	300	300	300	300	300
Rate/Passenger (fare) by year							
*1997	$3.25	$421,200	$456,300	$491,400	$526,500	$561,600	$596,700
1996	$2.50	$324,000	$351,000	$378,000	$405,000	$432,000	$459,000
1995	$2.00	$259,200	$280,800	$302,400	$324,000	$345,600	$367,200
1994	$1.50	$194,400	$210,600	$226,800	$243,000	$259,200	$275,400
1993	$1.00	$129,600	$140,400	$151,200	$162,000	$172,800	$183,600

*Estimate

Exhibit 3
ANTICIPATED VEHICLE PURCHASE COSTS (ALL PRICES IN US$)

Vehicle Description (year, brand and model, engine size, passenger capacity, and fuel type)	Import (into Durban) or Local (already in Harare)	Price	Durban Port Duty (port handling fees: fixed fee or percentage of vehicle price, highest fee used in final price calculation)		Clearance Fee (fixed fee)	Customs' Duty (Percentage based upon if vehicle is used for commercial vs passenger service)	Import Tax (fixed percentage of vehicle price)	Sales (fixed percentage of vehicle price)	Insurance (fixed fee)	License & Registration (fixed fee)	Commis-sion	Transport (cost to transport vehicle from Durban to Harare)	Total Vehicle Cost (Commercial Total Fees)	Daily Running Costs Regular Engine: cost/km (based upon 720kms/day (operating 12 hours/day, making 3 trips/hr, and covering approximately 20kms/trip))	Daily Running Costs Diesel Engine: cost/km (based upon 720kms/day (operating 12 hours/day, making 3 traips/hr, and covering approximately 20kms/trip))	Yearly Running Costs Regular Engine: cost/km/300 days/year (less insurance, registration and license)	Yearly Running Costs Diesel Engine: cost/km/300 days/year (less insurance, registration and license)	Vehicle Cost+ Yearly Running Costs Regular Engine	Vehicle Cost+ Yearly Running Costs Diesel Engine
			fixed fee	percentage		commercial							total fees	cost/km	cost/km	regular engine	diesel engine	regular engine	diesel engine
			$400	1.78%	$150	25%	19.5%	24.5%	$650	$40	$1,000	$6,250	$8,490	$0.26	$0.29				
1983 Nissan Caravan, 1.2L, 12 pass., Regular	L	$16,825							$650	$40			$17,515	$185.76	$207.36	$55,038	$61,518	$72,553	$79,033
1984 Toyota Hiace, 2.0L, 16 pass., Regular	I	$6,060	$400	107.868	$150	$1,515	$1,182	$1,485	$650	$40	$1,000	$6,250	$18,731	$185.76	$207.36	$55,038	$61,518	$73,769	$80,249
1985 Mitsubishi Delica, 2.3L, 17 pass., Regular	I	$6,035	$400	107.423	$150	$1,509	$1,177	$1,479	$650	$40	$1,000	$6,250	$18,689	$185.76	$207.36	$55,038	$61,518	$73,727	$80,207
1985 Toyota Townace, 1.8l, 14 pass., Regular	I	$5,500	$400	97.9	$150	$1,375	$1,073	$1,348	$650	$40	$1,000	$6,250	$17,785	$185.76	$207.36	$55,038	$61,518	$72,823	$79,303
1985 Toyota Townace 2.0L, 16 pass., Diesel	I	$5,565	$400	99.057	$150	$1,391	$1,085	$1,363	$650	$40	$1,000	$6,250	$17,895	$185.76	$207.36	$55,038	$61,518	$72,933	$79,413
1986 Toyota Hiace, 2.4L, 17 pass, Diesel	I	$7,475	$400	133.055	$150	$1,869	$1,458	$1,831	$650	$40	$1,000	$6,250	$21,123	$185.76	$207.36	$55,038	$61,518	$76,161	$82,641
1987 Toyota Masterace, 2.0L, 16 pass., Diesel	L	$19,800							$650	$40			$20,490	$185.76	$207.36	$55,038	$61,518	$75,528	$82,008
1988 Nissan Vanette, 1.5L, 15 pass., Regular	I	$5,830	$400	103.774	$0	$1,458	$1,137	$1,428	$650	$40	$1,000	$6,250	$18,193	$185.76	$207.36	$55,038	$61,518	$73,231	$79,711
1989 Toyota Masterace Surf, 1.8L, 15 pass., Regular	L	$18,620							$650	$40			$19,310	$185.76	$207.36	$55,038	$61,518	$74,348	$80,828
1990 Isuzu Fargo, 2.4L, 17 pass., Regular	L	$17,925							$650	$40			$18,615	$185.76	$207.36	$55,038	$61,518	$73,653	$80,133
1990 Toyota Hiace, 2.4L, 17 pass, Diesel	L	$21,500							$650	$40			$22,190	$185.76	$207.36	$55,038	$61,518	$77,228	$83,708

Exhibit 4

ETM'S RANKING ACROSS THE FIVE C'S

Factor		Grade *	Comments
Character		5	Standing in the Community; Church Relationships; Family; University Responsibilities and Positions; Hosting U.S. Exchange Students
	Stability	3.5	Other Businesses; Other Responsibilities (e.g,. home, family); Zimbabwe Economy; Financial Controls and Formal Budgeting
Capacity		4	
	Income	3.5	
			University Jobs; Other Businesses; Equity in Home; Family Overseas; Combi Business on the Rise
	Employment	4.5	Tenured; Department Chair; Published and Doing Research
	Payment Record	4	Minimal Experience with Large Commercial Loan; Usually Cash, Bills Paid on Time; Less Familiar with Credit, but Appears Timely
Capital and Collateral		4	Other Businesses; Investments; Parents and Church; Diverse Skill Base
	Available Assets	4	House; Personal Cars; Savings and Investments; Combis
	Insurance	4	Health Insurance; Life Insurance
Conditions		4	Zimbabwe Economy; ZCB Loan Guarantee Program; Popularity and Support for Small Business Development; Higher Barriers of Entry Due to Cost; Potential Saturation of Market

* Grade is based on a one to five (1-5) point scale. One indicates criteria clearly not attained, three equates to moderately attained and further review necessary, and five equals criteria clearly attained.

Eustina and Tawanda estimated that each day their combis operated about 12 hours and covered approximately 720 kilometers. From current automobile association statistics, they knew that vehicle running costs averaged about Z$.26 per kilometer.[24] Each combi averaged between two and four trips per hour (suburbs city suburbs city) and operated about 300 days a year. ETM paid drivers a fixed monthly salary of Z$1,250 and conductors (drivers' assistants) Z$850 monthly. To avoid accidents and maintain accurate fare collection, each combi had both a driver and a conductor.

Eustina and Tawanda knew passenger incomes were highly cyclical. As the end of the month neared, a family's available cash dropped. Many families did not routinely budget, but instead continued spending available cash until the next check arrived. Consequently, other things being equal, people stopped riding commuter vans at month-end in favor of ZUPCO buses. On the other hand, when weather was especially poor (such as when it rained), riders opted for commuters rather than wait for ZUPCO. As the quantity of combis and ETs grew, riders became increasingly selective. Riders no longer "jumped" into any type of vehicle. Instead, they waited for higher quality vehicles. Thus there were incentives to own newer vehicles.

Vehicle Purchasing: Local Supply Versus Import

Vehicles purchased overseas were significantly cheaper (often half the price) than comparable vehicles purchased locally. Exhibit 3 shows how ETM anticipated its vehicle costs. Vehicles purchased outside Zimbabwe required payment in U.S. dollars. Port handling fees for Zimbabwean goods, however, were payable in South African rand (the port of entry was Durban, South Africa). Durban port charges (the port handling fee) were either R100[25] or 1.78 % of the vehicle purchase price, whichever was higher. All custom duties, import taxes and sales tax were payable in Zimbabwe dollars. The port charged a Z$1,500 clearance fee for initial inspection and parking lot storage. In addition to a port charge and a clearance fee, the government assessed taxes and duty based on vehicle purchase price. These include 25% customs duty,[26] 19.5% import tax, and 24.5% sales tax.

Finally, buyers could either transport the vehicle themselves or pay Z$6,250 for an outside transport company to move the vehicle. Transport time from South Africa was usually two to three days once the vehicle arrived in Durban. Actual time from order to delivery varied from five weeks to three months. Vehicles were also available locally, at a higher cost, pending transfer of payment, registration and title.

Loan Criteria

Over the past months, Nyasha encountered first-hand the truth behind the comment, "Bank lending tends to be more of an art than a science, and assessing credit risk with limited information is often a skill developed over time." With limited financial statements with which to work, she recalled a university business class that taught lenders to consider the 5 C's when evaluating a loan: character, capacity, capital, collateral and conditions. While this approach might not provide a detailed assessment of the proposed cash request, given the Zimbabwe context, the nature of small business loans and ZCB's recent entry into small business lending, it was a useful assessment tool. Nyasha's initial 5 C assessment is seen as Exhibit 4.

Character reflects the loan recipient's integrity, honesty and morality. It also reflects the recipient's commitment to repay the loan and abide by the loan contract's terms and conditions.

Capacity reveals the loan recipient's ability to repay the loan along two dimensions: financial and personal. In financial terms, the applicant must have enough income to cover the loan. Additionally, cash flows must be consistent rather than irregular. As for personal, the ideal candidate will continue in his or her current job or take an equivalent job. Spending patterns should also remain fairly constant. Capacity also addresses whether the loan recipient can sustain unexpected expenses.

Capital considers the unexpected. The successful recipient has a contingency plan and adequate resources should an unexpected expense arise. Therefore, supplemental or alternative income sources should exist.

Collateral is assets that are easily sold, readily available and of equal or greater value than the amount of the loan requested. If the applicant does not repay the loan, the collateral must cover the loan amount.

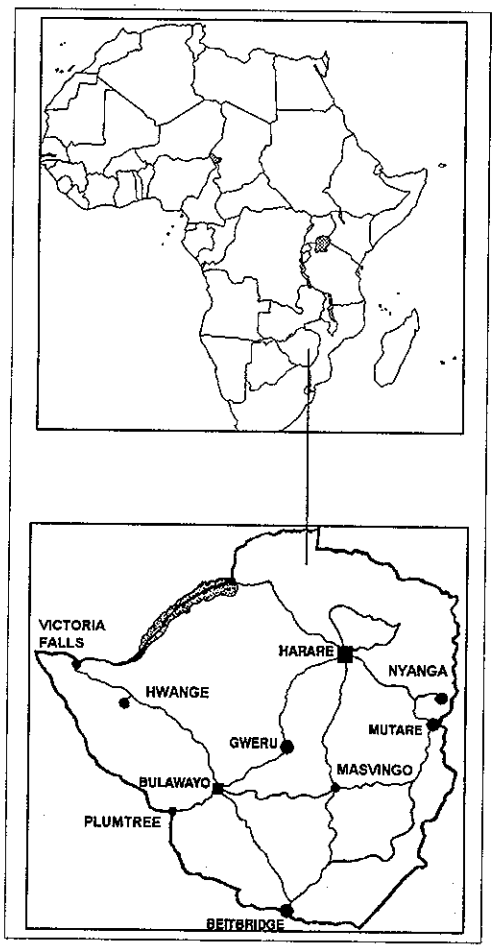
Conditions refer to the business environment. The environment should promote small business and provide a healthy market for the type of business seeking the loan. Moreover, barriers to entry and risk must be evaluated.

In addition to these five conditions, Nyasha considered the following factors: the cost for purchasing another transport vehicle locally or internationally, the number of additional new vehicles needed, the passenger capacity of each vehicle, their running and maintenance costs, the type of fuel required, the potential new revenue streams, the proposed changes in tax rates, the anticipated customs charges and the possibility of currency devaluation. She also asked ETM about the time delay from combi purchase until its actual use.

As for lending criteria, she wanted to keep it simple.

Exhibit 5

MAPS OF AFRICA AND ZIMBABWE



Scanning local interest rates, she saw that rates varied between 35-42%. ZCB suggested 40% for its larger and longer term loans; most of its small loans were from 34-38%. She picked 37% over three years. Again, based on other lenders in the area, the application fee was Z$100, with a 3.5% processing and administrative fee. The first loan required a nonrelative to co-sign.

She spent the better part of the day doing the analysis. As she completed her preparations, the sun began to set. She pulled together her notes, calculator, ETM information and wrapped up her work for the day to go meet with ETM. For her meeting tomorrow, she now had selection criterion (the five C's), a good assessment of ETM's situation and an overall understanding of economic conditions in her country. Considering these standards, Nyasha believed ETM's loan request was appropriate. Despite her remaining questions, she had confidence in ETM and believed that if ETM's successes continued, ZCB's image would surely improve. Given the loud call for indigenization in the country, ZCB would be seen as a strong promoter of small- and medium-sized black-owned businesses.

Nyasha put on her coat and walked down the hall to the elevator. To her surprise, just as the elevator doors opened, Edwin Chakanesta, the head of the loan division, emerged from his office and followed her into the elevator. Riding together down to the lobby, Edwin learned of her decision and then raised the question, "So, a passenger transport business appears to be ZCB's first loan? Sounds risky. I am curious to know what selection criteria you employed and your analysis of the industry. By the way, don't forget diesel fuel prices go up tomorrow." As the elevator doors opened, Edwin said manheru.[27] Nyasha wondered if she had fully considered all the options and made the appropriate assessment.

Appendix

Zimbabwe Background Information

The Great Stone City[28]

Zimbabwe is approximately 150,870 square miles, or slightly larger than Montana, and similarly landlocked. Located around Zimbabwe are South Africa to the south, Mozambique to the east, Zambia to the north and Botswana to the west. See Exhibit 5.

Called Rhodesia when it was part of the British empire, Zimbabwe became an independent nation in 1980, ruled by a black majority[29] with Robert G. Mugabe as its Prime Minister and later its President. He was still in office at the time this case was written. English is the official language taught in school and used in business, but two other languages are spoken: Shona and Ndebele. The Shona people (largely in the northern part of the country) constitute 71% of the population, and the Ndebele people comprise 16%. Ninety-nine percent of Zimbabwe's population is black, with the remaining population consisting of whites,[30] Europeans and Asians.[31]

Since independence just 16 years ago, peace, higher literacy levels, increased access to food, technology, vehicles and entertainment options, as well as increased access to tourist destinations, are noticeable improvements. However, Zimbabwe's roads, housing, water and sanitation systems and hospitals are quickly decaying. The country's ability to sustain a growing population is increasingly uncertain. Without a port, Zimbabwe is dependent on its road, rail and air links, yet all three transportation methods are inefficient, with immediate need to expand their conditions, capabilities and access. At the same time, corruption and increasing government control are prevalent. Specific examples include preventing private telephone systems access to licenses, awarding airport expansion contracts to the highest bidder (the President's nephew), reducing airtime for

CNN world news and restricting the editorial freedom of Zimbabwe newspapers.

Agriculture remains a significant part of Zimbabwe's economy. However, since considerable portions of Zimbabwe are arid, drought is an ongoing concern. From 1992 to 1994 and again in 1995, Zimbabwe faced its worst droughts since 1911. Agriculture, the traditionally strong performer and vital sector of the economy, suffered output declines of 25%, cutting national economic growth (real GDP) to 1-2% versus the decade high of 7.4% in 1994.[32]

This had a dramatic impact on the economy, with cascading negative consequences. Unemployment rose. Reduced agricultural exports cut foreign currency inflows. To prevent starvation, importing food pushed up government debt. As a result, food prices rose. Without adequate water, Lake Kariba hydrologic dam, a major energy source, stopped operating, forcing Zimbabwe to buy energy (petroleum, natural gas, electricity) from its regional neighbors. These neighbors were unreliable suppliers; they faced substantial costs, and they were inconsistent in delivery (e.g., Mozambique faced post-civil war conditions, South Africa recently attained independence and Zambia's distribution system was completely undependable and incomplete). Finally, a rapid population transition from rural to urban areas placed further stress on Zimbabwe's fragile support system.

Zimbabwe currently faces chronic unemployment, a significant problem. Each year between 200,000 and 300,000 students graduate school, yet only 20,000 to 30,000 find jobs. The remaining 90% struggle, attempting to live with meager jobs and insufficient pay and benefits. Thus many individuals have pursued small businesses, but are quickly blocked by legislation, expensive licenses and their lack of established credit.

In 1990, with funding from the International Monetary Fund and the World Bank, the Government of Zimbabwe launched a "Framework for Economic Reform," or an Economic Structural Adjustment Program (ESAP). ESAP targeted four main areas: (1) deregulation of the domestic economy through market-driven competition and the reduction in government subsidized parastatals;[33] (2) trade and exchange liberalization facilitated by a reduction in foreign exchange and import restrictions; (3) stabilization of inflation and interest rates and (4) reduction of government budget deficits from ten to five percent by cutting 25% of the civil service employees.[34]

The Government reduced its budget deficit by 2.5-3%, and attained minimal short-term progress in privatization, stabilizing unemployment, lowering inflation and controlling currency devaluation. However, while ESAP should improve Zimbabwe's economy in the long-term, hardest hit were those at the lowest economic and social levels. They are unable to live with the higher prices for goods and services and the severe contraction in government social services. One scholar noted, "Rural peasants, urban slum dwellers, female headed households and children of the poor have felt the effects of structural adjustment most severely."[35]

Meanwhile, Zimbabwe has great potential. The country is peaceful with a high literacy rate. Its people are friendly, hardworking and resourceful. High quality and quantity of food, technology, vehicles and entertainment options are available to those financially well-off or the international visitor paying cash. Tourist destinations offer unparalleled scenery, including majestic waterfalls, open savannas, magnificent mountains and impressive national parks with vast wildlife holdings. Natural resources such as natural gas, coal, ferro alloys and nickel are abundant. Europe routinely imports fresh flowers and vegetables from Zimbabwe. Zimbabwe is one of the largest exporters of flue-cured tobacco, sold to buyers worldwide.

In certain Zimbabwe suburbs, the visitor quickly notices beautifully decorated homes and gardens, often surrounded with gates. Grocery stores are clean and amply stocked. Nearby, upmarket hotels stand among shops with new fashions prominently displayed. Varied entertainment centers and recently built or refurbished sporting venues offer fun in peaceful surroundings. Westernized food courts, fresh bakeries and excellent restaurants complement shopping centers and strip malls in the two largest cities. Given this environment, it is possible to believe that doing business of any type in Zimbabwe is easy. With the modern conveniences such as plentiful shops, cars, airports, banks, modern facilities and advanced technologies (computers, fax machines, laser printers), business activities are well supported.

However, contrasts remain. Around the tall steel and glass buildings and late model cars in the downtown areas, many street vendors sell cigarettes, newspapers, fruit and candy to the passing masses while homeless parking boys hustle for spare change.

NOTES

1. (Pvt.) Ltd. means private limited, referring to a privately held company.

2. This case was written by Michael Eber of the Atkinson Graduate School of Management, Willamette University, Salem, Oregon. Prior to Zimbabwe, Eber worked for an economic, market research and management consulting firm, as well as the U.S. Environmental Protection Agency (EPA). He also traveled throughout Africa and Oceania. Eber is a Colorado native. The case is intended as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

3. A Shona greeting meaning "Good morning." In Ndebele, the greeting is "*livuke njani.*"

4. Pronounced "Nie-osh-a Moo-ray-wah."

5. Nyasha, a black woman in her late twenties, has a certificate in economics and completed one year of university before leaving due to cost. After running her own small business, she began a banking career with a micro-enterprise lending organization as an accounts clerk and finance officer (bookkeeper). Nyasha then moved to ZCB as a senior finance officer and was later promoted to her new position. Lending to indigenous black-owned businesses was a new business area for the bank, not a conventional career step for white Zimbabwe bankers.

6. Pronounced "Ed-win Chaw-can-es-ta."

7. ZCB participated in a new USAID micro and small enterprise development loan guarantee program. USAID guarantees 50% of the loan risk, and the bank is responsible for the remainder. Two of the five major commercial banks in the country participated. It is interesting to note that three of the five banks were foreign owned (South Africa and U.K.), and one of these participated. ZCB is locally owned, but it was once a part of the ill-fated BCCI, the Islamic Banking group based elsewhere in the British Commonwealth that went out of business a few years before amid charges of corruption.

8. Competing small business loan applications being considered by ZCB came from: a construction company, a Zimbabwe art and textile exporter, an international fruit and vegetable exporter, a solid waste recycling operator and people seeking funds to purchase a restaurant or food product franchises.

9. Pronounced "U-steen-a and Tah-won-da Mad-un-hu-ree-wah."

10. Small privately-owned passenger vehicles transport people from the suburbs to the city. They are called combis or combi vans. Being in the combi business or the passenger commuter industry are equivalent. These terms are used interchangeably throughout the case.

11. Such limited financial information helped to make this new business area quite different from established areas of the bank, where lending decisions were based on common forms of financial analysis.

12. Religion and church are serious issues in Zimbabwe. While the population is largely Christian, there is a move towards more evangelical forms, or Pentecostalism. Many, especially those in the rural areas, see religion as a provider of hope and inspiration, and most participate in church activities for the social network and business contacts.

13. Although it was a holiday weekend, the crews from ZESA (Zimbabwe Electric Supply Authority) and PTC (Posts and Telecommunications Corporation), two government-owned monopolies, sought work opportunities because wages are often double the usual Monday-to-Friday rate. Substandard telephone service is common throughout Zimbabwe and a frequent topic in the news. For instance, the May 30, 1996, *Business Herald* noted:

> "Zimbabwe has one of the poorest telecommunications systems in Africa . . . with a high failure rate, slow service response time, tremendous backlog (given the current rate of new installations and the present backlog, it would take PTC 14 years to meet the present demand), and non-standard 20-30 year old worn out and obsolete equipment. The net impact: failure in luring foreign investment and possible lawsuits for loss of business."

14. Exchange Rate (average 1US$:Z$):

1990	1991	1992	1993	1994	1995	1996	1997 (est.)
2.5	3.6	5.1	6.5	8.2	8.7	10.2	12.0

15. Family relationships, whether immediate or distant, are a meaningful element of Zimbabwe society. If one family member is doing especially well, usually financially, that family becomes a "haven" for all other family members. The "thriving" family member then assists the others financially and emotionally.

16. AIDS (Acquired Immunity Deficiency Syndrome) was hugely under-reported in Zimbabwe. The Zimbabwe government estimated the number of AIDS and AIDS-related cases at ten percent of the population, and that about one percent of the population (over 100,000 people) would die of AIDS within the next 18 months. However, non-government agencies predict that over 65% of the Zimbabwe military is HIV-positive. One of the many indicators of misunderstanding regarding AIDS was evident in a recent comment by former Zimbabwean vice-president Joshua Nkomo at the graveside of his son who died from AIDS: "AIDS was brought to Zimbabwe by white people who intended to wipe out the black population and take its land and wealth . . . however [whites] were not smart enough to make sure they had the cure."

17. Economic Indicators:

	1990	1991	1992	1993	1994	1995	1996	1997 (est.)
Real GDP Growth (%)	2.2	3.2	-5.8	.9	7.4	-3.2	7.0	5.6
Consumer Price Inflation (%)	17.7	23.2	42.1	27.6	22.2	22.6	21.0	18.0
Population (millions)	9.4	9.6	10.4	10.6	10.9	11.3	11.8	12.3
Formal Sector Unemployment (%)	-	-	-	44.5	46.0	48.0	45.0	50.0

Sources: *Financial Gazette*. Harare: Zimbabwe, 25 April 1996, p. 6;

Economist Intelligence Unit Limited. "Zimbabwe-4th Quarter." 1995. Country Report. New York: NY;

Economist Intelligence Unit Limited. "Zimbabwe-1st Quarter." 1996. Country Report. New York: NY;

U.S. Embassy. "Country Commercial Guide Zimbabwe." Harare: Zimbabwe, June 1995;

U.S. Department of Labor, Bureau of International Labor Affairs. "Foreign Labor Trends." Washington DC: Government Printing Office, 1994.

18. Eustina, expert cook and pastry maker, furthered her skills during a sabbatical in the United States. At the time she attended advanced cooking courses specializing in desserts under Maida Heatter, the master pastry chef.

19. The AA, for a fee, graded motorists on a risk scale from 1-10 based upon accidents, speeding tickets and other motor vehicle violations. A 1 indicates high or extreme risk, while a 10 reflects minor or no risk.

20. ZUPCO (the Zimbabwe United Passenger Company) was the government's passenger transport business. This monopolistic and highly subsidized operation transported passengers from the suburbs to the city. However ZUPCO was plagued with problems. For instance, buses ran infrequently or failed to show, because breakdowns were common and drivers were not keen on getting anywhere quickly. As a result, people living as close as 12-20 kilometers from city center (normally a 10-20 minute commute) arrived at work after 9:30-10 a.m., even though they were at the bus queue (line) at 5 a.m. At the end of the day, people would complete work between 4:30-5 p.m. and wait several hours for the bus. Often, they would not return home before 10 p.m.

"Simply speaking, ZUPCO drivers have no incentive to perform," noted one of ETM's drivers. The ETM driver went on to explain this about ZUPCO: "ZUPCO drivers were paid regardless of how many passengers were collected, how often a route was completed, or how timely they traveled from one stop to the next. In some sense, the drivers believed they were

providing a special service to the community and did not feel any great reason to hurry. Besides, the faster they drove or the more times they completed route, the more fuel the buses consumed, therefore costing more money to run that bus. ZUPCO was a highly subsidized and poorly managed government monopoly. As a result, ZUPCO never saw the revenue but only the expenses!"

21. Whites typically lived in the northern suburbs and blacks lived in the southern suburbs, often 25-40 kilometers away from the city center. The housing density in white suburbs was less than in black suburbs. Furthermore, services (water, electricity, sewer) and incomes were less in black than white areas. Less income coupled with larger family sizes resulted in less disposable income available for transportation or vehicle purchase.

22. From 1965-1980 (during UDI, or the Universal Declaration of Independence), Zimbabwe's imports were severely restricted, and few choices existed for buying cars. Those that did exist were extremely expensive. However, in 1985, the Bulawayo paper, *The Chronicle,* first reported a story later referred to as the "Willowvale Scandal." The story centered on the sole Zimbabwean auto maker, Willowvale Motors, and the long waiting list for new cars. Buyers often waited 9-18 months following payment. Yet, numerous government ministers utilized their positions of influence and "jumped the queue." In addition to moving ahead on the waiting list, they would order several cars at once, often at discounted prices. When *The Chronicle* printed the story and allegations were investigated, five ministers resigned. Meanwhile, instead of promoting *The Chronicle's* journalist, the paper reassigned the writer to cover less substantial news outside the region.

23. Peugeots are built throughout Africa, including Zimbabwe, a former British colony. According to locals, Peugeots are popular cars given their long-lasting and reliable performance, and their appropriateness for the African environment (e.g., heavy shocks, substantial axles and large cargo spaces). Another reason Peugeots exist in Zimbabwe stems from UDI-induced trade restrictions that limited other imports. Under UDI sanctions, even Peugeots were unofficially imported.

24. Per kilometer vehicle statistics were based on regular fuel engine size between 1.6 and 2.7 liters, with a base purchase price between Z$100,000-380,000 and the cost of petrol, lubrication, oil, and sundry repairs. Diesel fuel vehicles ran at Z$.29 per kilometer.

25. US$1 = 4 South African rand.

26. Normally "passenger" vehicles were assessed at 105% duty since Zimbabwe is actively encouraging local vehicle purchase. However, if purchasing a vehicle for "commercial" purposes, the government drops the customs duty to 25%. High duties were set by the Zimbabwe government to protect local businesses from less expensive goods coming from South Africa.

27. A Shona greeting meaning "Good evening." In Ndebele, the greeting is "litshone njani."

28. Zimbabwe comes from the Shona word meaning great stone city or stone houses.

29. Despite the political change, the white minority still controls many large businesses and retains significant land holdings. In an effort to reverse white ownership, the Government of Zimbabwe began a program called indigenization: converting executive positions, businesses and land back to blacks. The controversy surrounding indigenization remains, as noted in the June 1st, 1996, issue of the *Zimbabwe Independent:* "Race issues are not new to Zimbabwe . . . the gap between whites and blacks is widening to the detriment of the latter. [On the other hand], some believe that blacks are unfit to govern and they lack the requisite skills pointing out other independent African countries that economic collapse is the rule of the day when blacks are left to their own devices. [Meanwhile], there remains lots of stupid intransigence within white circles and pathetic paranoia of a group clinging to a bygone era and living out of their Tudor style shopping malls cocooned in privileges which for the most part they have not earned but by which are theirs merely by accident of birth."

30. An important distinction is made between whites and Europeans. While white Zimbabweans were initially of European descent, their families, often two, three and possibly four generations back were born in Zimbabwe (or formerly Rhodesia). Consequently, white Zimbabweans believe they are just as much "indigenous" people as black Zimbabweans. Europeans are the more recent arrivals who are now residents of Zimbabwe.

31. Zimbabwe Ministry of Information, Posts and Telecommunications. *Independent Zimbabwe 1995.* Harare, Zimbabwe: Government Printing, April 1995.

32. U.S. Embassy. *Country Commercial Guide: Zimbabwe.* Harare, Zimbabwe: U.S. Embassy, June 1995.

33. Government owned and regulated businesses such as commodity boards, telephone system, broadcasting, airlines and minerals marketing boards.

34. Bell, R., Peters, G., and Ndiweni, M. "Zimbabwe: Financial Sector Assessment," *Gemini Technical Report* #85. Bethesda MD: Developmental Alternatives, Inc., August 1995.

35. Nichols, P.M. "Swapping Debt for Development: A Theoretical Application of Swaps to the Creation of Microenterprise Lending Institutions in Sub-Saharan Africa," *International Law and Politics,* 1994, 27(43), 65.

Growing Pains

MANAGEMENT CHALLENGES IN AN EMERGING FINANCIAL MARKET[1]

Kathmandu, Nepal

January 1995

One could feel the tension in the air at the daily hour-long Management Committee meeting of World Finance and Savings Co., Ltd. (WFS), a three-year-old Nepalese finance company and the first private financial institution of the country. The topic of today's customary monologue from the Executive Director, Sanjay Shrestha, was whether or not to show accrued interest expense in the company's financial statements. He did not want it included.

"I only have the best interests of the company in mind," he said. "But we cannot go to the Annual General Meeting (AGM) without showing a profit, no matter how small."

Sushim Sherpa, the Marketing Officer, did not want to outwardly contradict the Executive Director, his superior, or to appear to confront him directly, but he felt that adjusting the figures to make the business look profitable was the wrong thing to do. Diplomatically, he queried, "But aren't there other views to consider in this situation? We must not only think of today, but also plan for tomorrow."

It was as if the Executive Director had not heard Sushim's words. "How will the company survive if two years in a row we have a loss? All the other finance companies are showing generous profits." His voice grew shrill. "I cannot face the AGM with a loss!" He soon ended the meeting pounding his fist on the table and proclaiming: "I will resign if the Board does not agree to 'show' a profit! It is all up to them!"

Five Months Earlier

During the past year, WFS had engaged two consultants to help the bank solicit deposits and raise profitability. The results were disappointing: not one additional Nepali rupee (NRs) had been deposited through their efforts. It was after these two unsuccessful attempts that the Board finally decided to create a full-time marketing position. Sushim Sherpa, hired directly by the Chairman for his independent thinking, was brought in to lead the firm out of the red. His main assignment was to devise a plan to resolve the problems of deposit mobilization.[2] This project led him step by step into issues of raising capital, then loan recovery, and ultimately, financial reporting (including what to include on the balance sheet). In addition, he was assigned the onerous task of organizing the AGM.

Sushim had little time to assess the slow deposit situation before he was called away to solve a pressing cash flow problem. The loan department had closed for two weeks because there were insufficient funds available from deposits to continue lending. The low level of deposits was due to the upcoming Nepali holidays of Dashain and Tihar, when most people returned to their family villages in the countryside and spend money on food and presents. The processing of loan applications was delayed in hopes that deposits would flow in after the holidays.[3] The Executive Director, Sanjay Shrestha, told Sushim to drop everything and focus his efforts on a deposit mobilization campaign aimed at increasing fixed deposits, currently at NRs.340 lac ($680,000), by an additional eight lac ($16,000)[4] to meet monthly

expenses. Sushim thought to himself, "This is the biggest holiday season of the year. Why wasn't this taken into consideration when estimating deposits?" In Sushim's opinion, the crisis could have been avoided with proper planning. This oversight was just a small sign of things to come.

WFS History

In January 1992 WFS was one of the first finance companies established in Nepal. WFS started operations with 40 lac ($80,000) in capital (50% of the capital was initially collected, and the remaining 50% was to be called at a later time). The shareholders included 11 "promoters" (major stockholders) who owned 51% of

Exhibit 1

FINANCE INDUSTRY IN NEPAL

Groups A, D were established after the 1984 deregulation of the financial sector (except for A1, A2).

Groups B, C, E were formed after 1992.

Formed after 1984:

A. COMMERCIAL & RURAL DEVELOPMENT BANKS

1. Nepal Bank Ltd. | *the country's 2 original*
2. Rastriya Bannijya Bank | *state-owned banks*
3. Nepal Arab Bank, Ltd.
4. Nepal Grindlays Bank
5. Nepal Indo Suez Bank
6. Himalayan Bank, Ltd.
7. Nepal SBI Bank, Ltd.
8. Nepal Bangladesh Bank
9. Everest Bank
10. Bank of Kathmandu
11. International Finance Investment & Commercial Bank Ltd.

D. INSURANCE COMPANIES

1. Rastriya Beema Sansthan (National Insurance Co.)
2. Himalayan General Insurance Co., Ltd.
3. Life Insurance & General Co.
4. National Life & General Insurance Co., Ltd.
5. United Insurance Co. (Nepal)
6. Everest Insurance
7. Premier Insurance

Formed after 1992:

B. FINANCE COMPANIES

1. Annapurna Finance Co.
2. Himalaya Finance & Savings Co.
3. Himalayan Securities & Finance Co.
4. Kathmandu Finance Co., Ltd.
5. Mercantile Finance Co.
6. National Finance Co., Ltd.
7. Nepal Finance & Savings, Ltd.
8. Nepal Housing Development Finance Co., Ltd.
9. Nepal Share Markets Co.
10. People's Finance Co.
11. Union Finance Co.
12. United Finance & Leasing Co., Ltd.

C. COOPERATIVES

1. Nav Jeevan Cooperatives
2. Nav Kshitiz Cooperatives
3. Nepal Cooperative and Finance Co.
4. Sagun Cooperatives
5. Nirdhan
6. Self Development Centre

E. CREDIT GUARANTEE CORPORATION, SECURITY BOARD, STOCK EXCHANGE

1. Citizen Investment Trust
2. NIDC Capital Markets Ltd.

Source: "Booming Business," *Spotlight*, 11 November 1994, p. 10.

the company. The motivation behind the establishment of the firm was not only monetary gain but also altruism. The original intent was to provide opportunities for the Nepalese people to improve their economic situation by saving, borrowing and investing.

The first two and a half years of existence were difficult for WFS. During the first year, the Board of Directors divided into two factions, with one side supporting the Chairman and the other side favoring another candidate. The sides disagreed over their preferred direction for the company. In the end, threats were made against the staff and Directors' families in an attempt to sway votes. During this period, a Central Rastra Bank[5] representative was brought in to monitor operations and settle the conflict. The first AGM was held without a Board of Directors and a loss was declared. Six months later, the Central Rastra Bank representative left after a resolution had been reached with the second faction agreeing to sell their interest to the first. WFS was reborn with a new Chairman, a new Board and new offices. By then, however, the initial advantage of being the first finance company in the nation was lost, and the competition had grown significantly. During those two years, 15 new finance companies had opened up, as well as commercial banks and savings cooperatives offering a wide range of services. These new institutions were founded with much more capital—up to four krore[6] or ten times that of WFS. As expected, WFS's operations were greatly affected by the conflict and during this period its deposits dwindled to almost nothing.

The Banking Industry

With only two commercial banks and one development bank as of 1984, Nepal's banking sector was quite small. Financial liberalization started in 1984 with the establishment of the first joint venture bank, Nepal Arab Bank Ltd., after which a number of venture banks were launched. In 1985, the Finance Company Act was enacted allowing incorporation of finance companies to conduct nonbanking business as public limited companies.[7] Even with this legislation, however, significant change did not take place until the democratic election in 1991.

With the new democratically–elected government in Nepal in 1991 and the regional shift towards economic liberalization in India, a new attitude towards development grew within the Kingdom of Nepal. Until 1992 the financial sector was dominated by two state-owned banks, which controlled 70% of all banking deposits. These two banks proved to be a considerable drain on the financial community and were restructured in 1991 due to millions in outstanding loans. Official reported figures showed that as of the end of January 1994, overdue loans at the two banks amounted to some NRs.2.8 billion ($56 million) and were increasing.

The establishment of WFS in 1992 started a new phase in the financial sector. So far, 18 finance companies accepting public deposits had started operations. Numerous other petitions still awaited approval at Central Rastra Bank. Since inception of deregulation in 1993, the total volume of net domestic credit had increased by 15%. The expansion of credit to the private sector accounted for most of the increase in domestic credit. Another significant development in the banking sector was the interest rate policy, which was earlier controlled and regulated by Nepal Central Rastra Bank but was deregulated in 1989. Commercial banks and finance companies were free to fix their own interest rates on deposits and loans, with a maximum six percent spread.[8] However, a local economist, Dr. Kishort K. Gurugharana, noted that "the development of financial sector per se is not bad, but it owes more to global factors than the liberalization policy of the government."[9]

Nepal Stock Exchange (NEPSE)

The Finance Company Act changed the shape of the finance industry by opening up many opportunities including the development of a stock exchange. NEPSE opened its trading door on January 13, 1994. After one year in business, the infant capital market was trying to speed up its pace with limited success. With 74 companies listed, share prices went higher in the beginning but then started to come down when the government changed hands following the Communist party's election victory. The new government's alleged indifference towards the growth of the capital market was criticized by investors and brokers.[10] "The government has not introduced its policy regarding the capital market, which has made its future uncertain," complained H.P. Dev, an investor.[11]

Lack of a systematic information flow, inadequate knowledge of market procedures and excessive risk-taking left the common investor vulnerable. With the opening of the floor, most of the companies' values rose regardless of performance. NEPSE officials held the view that the market was beginning to reflect real values. NEPSE had 74 companies listed for trading purposes with only 45 attracting regular transactions. Most of the companies still did not make their financial positions transparent to the public even though this information was required for share trading.

Deposit Shortage

Anxious to have a recommendation prepared for the upcoming Board meeting, Sushim called the first Management Committee meeting[12] to brainstorm ways to solve the immediate problem. After reviewing several options, including the possible use of TV commercials

Exhibit 2

WFS PROFILE

Purpose: WFS was established to perform nonbanking functions through institutionalized investment of capital to promote the economic interests of Nepalese people by providing loans for hire purchase, housing, trade and industry finance, merchant banking, trust management, leasing and other financial resource mobilization plans, as prescribed by the Finance Company Act, 1985.

Mission: WFS's mission is to provide total customer satisfaction by constantly striving to meet the changing financial needs, wants and expectations of its customers, both explicit and implied. WFS strives to contribute to the betterment of the country's economy by creating job opportunities and promoting development of an entrepreneurial spirit both nationally and globally.

WFS is the first financial institution in the private sector in the Kingdom of Nepal. Established under the Financial Company Act 2042 (First Amendment 2049), WFS was founded in Shrawan 2049 BS (July 1992).

WFS's Distinctive Features:

- Higher interest rates on deposits compared to banks and many other financial institutions.
- A team of highly motivated, professional, trained staff.
- Customer-friendly environment.
- A hassle-free computerized system.
- Greater flexibility on hire purchase loan schemes.
- Convenient industrial loans.
- Personalized, efficient, prompt and courteous services.
- Market-driven company.

WFS's Main Areas of Service

DEPOSITS

(1) Fixed Deposit

Period	Interest Rate (per annum)
6 months	9.00
1 year	11.00
2 years	12.00
3-5 years	12.50

Features:
- Minimum deposit amount NRs.10,000.00
- Interest given every three months
- Interest deposited at the bank of client's choice

Interest rate on deposits is negotiable depending upon the deposit amount and deposit period.

(2) Recurring Savings Scheme

Under this scheme, an account can be opened with a monthly deposit amount divisible by NRs.100 (Maximum NRs.5,000). After 42 months, a lump sum amount will be paid out. Minimum deposit amount is NRs.500.

(3) Pre-Interest-Marked Deposit Scheme

Features:
- Minimum deposit amount NRs.10,000.00
- After 5 years, double the deposited amount will be paid out
- A guaranteed letter of deposit amount will be issued to the depositor

Under this scheme, account cannot be opened without approval of the company.

INVESTMENTS[13]

(1) Hire Purchase Loan

With minimum cash down payment of 20%, loan can be sanctioned (applicable interest rate on loan-3% flat) for the hire purchase of the following items:

- Transportation vehicles
- Agriculture, engineering and medical equipment
- Household appliances
- Office equipment
- Furniture and fixtures

Hire purchase loan period: one to five years

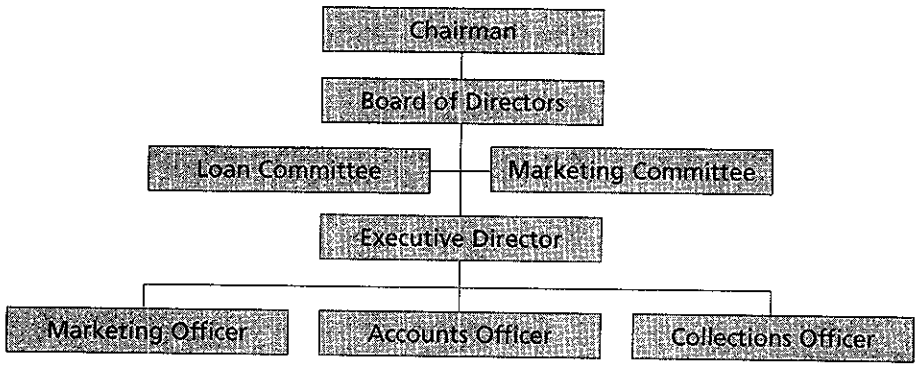
(2) Industrial Loan

With minimum cash down payment of 20%, loan can be sanctioned (applicable interest rate 18.5% simple) for small- to medium-sized industries.

- Housing finance
- Merchant banking
- Leasing finance
- Trade finance
- Bill discounting
- Trust management

Exhibit 3

ORGANIZATION CHART[1]



1 WFS had a Board consisting of nine directors; five were promoters and four were minority shareholders elected at the AGM. There were 12 employees, consisting of an Executive Director, three Officers, four assistant supervisors and four messengers.

Exhibit 4

MAIN PLAYERS

Chairman

Mr. Santos Sherpa was a well respected economist and intellectual, with vast international experience developing policy for large development organizations. Unfortunately, he had little experience running a small business and has hired numerous consultants over the last six months to improve the firm's operations. He was eager to implement western ideas, such as Management by Objectives and Total Quality Management at WFS.

Executive Director

Mr. Sanjay Shrestha was a seasoned bank executive with 20 years experience in state-owned banks. He had strong connections in the banking sector, but it was unclear if he was able to meet the challenges facing a market-driven institution. He was of Newar decent, the predominant tribe in the Kathmandu valley, an asset in the eyes of the Directors. He was brought in to implement control systems previously missing in day to day operations.

Marketing Officer

Mr. Sushim Sharma recently returned from five years working and studying in the United States, where he received his MBA. A member of the Braham caste,* Sushim was on his third job after returning from abroad. He was full of energy and enthusiasm to implement the new theories he had learned in the West but appeared to have difficulties readjusting to the Nepalese way.

Company Secretary

Mr. Rajesh Singh was heavily involved with WFS as the Company Secretary, Promoter and Director. The feelings of dislike between the Executive Director and Mr. Singh disrupted every meeting the two attended. It was unclear each time who was right or wrong, and no one could control them at meetings. A lawyer and the youngest Promoter and Board Member, Mr. Singh had most of his money invested in WFS. He was trying to move the firm in the right direction but this was always in direct confrontation with the Executive Director.

*The caste system, though illegal, still plays a strong role in society, with Braham and Chetri being the top two classes. One's caste is identifiable by one's last name.

and the raising of interest rates, it was agreed to investigate providing health insurance for depositors as an avenue to increase deposits.[14]

Sushim was satisfied with the outcome of the meeting, but felt the others were reluctant to proceed with the plan. He overheard the Accounts Officer whispering, "WFS needs deposits now, but soon we won't be able to accept any more money."

Confused, Sushim shook his head and asked the Accounts Officer to repeat himself. Did he hear correctly? "You mean our target is only to raise the eight lac needed for this month's expenses? What's going on?"

The Accounts Officer explained that WFS was approaching the deposit saturation point as prescribed by Nepal's Central Rastra Bank Law. According to his calculations, in three months or less the firm would not be able to accept any more deposits. WFS would reach deposit saturation, the maximum leverage point allowed by law. The deposit limit was constrained by the amount of capital.[15] With 40 lac in paid-in capital, WFS's maximum deposit level was 400

Exhibit 5

WFS CAPITAL STRUCTURE
(NRs.)

September 1994

Authorized capital*	2,00,00,000
Issued capital	1,00,00,000
Paid up capital**	50,00,000
Reserved right share	20,00,000
Current total shares	40,00,000

* Nepal and India use the same units of measure:
100,000 = 1,00,000 (1 lac)
10,000,000 = 1,00,00,000 (1 krore)

** During initial offering, only 50% of share price was collected.

lac ($800,000).

"OK, so the real constraint here is capital. Fair enough. So why don't we raise the capital?" Sushim asked excitedly. Finally, he felt the real problem had been identified, and he set to work to propose raising new capital.

Mid-September 1994

After working a solid week on the proposal to the Board, Sushim was ready to present his findings. By that time, WFS had received NRs.1.2 million (12 lac) in deposits, eliminating the cash crisis. However, the deposit saturation problem still loomed.

Exhibit 6

DEPOSIT MAXIMUM FORECAST
(lac)

	October/ November	December/ January	May
Total deposit estimate* (in lacs)	360	400	500
Deposit maximum**	400	400	500
Paid up capital	40	40 + 10	50

* Based on adding monthly increments of 20 lac (based on monthly average).

** Legally mandated deposit maximum = 10 x paid capital.

As a new member of staff, Sushim was formally introduced at the September Board Meeting. However, no one informed him that the meeting had started an hour earlier and that the messenger had not yet returned with his report from the photocopy store down the street. On the surface it appeared the Board knew of the deposit problem, but they were alarmingly unaware that it was a constraint to growth. Everyone was interested in growth and profit, but the Board did not understand how the deposit limitation impacted the bottom line. Sushim was beginning to realize that while the Board members were well respected professionals, few had hands-on experience operating a business. The Executive Director assured him that he would be given a chance to speak later in the meeting. Later never came, and after waiting three and a half hours, the Executive Director informed Sushim he could go home and the proposal would be discussed another day (which also never came). The deposit saturation problem was never discussed. This would not be the last time agenda items were overlooked at a WFS Board Meeting.

Slightly frustrated by not having had the opportunity to discuss his ideas with the Board, Sushim discussed his concerns with the other Officers. He also took advantage of the opportunity to clear up a few loose ends. "Why does WFS only provide two investment channels (hire purchase and industrial) when our competition is offering a greater variety of services?" he asked.

He was told that the types of investments WFS could make were limited by the amount of paid up capital, as well as by the deposit ceiling. Nepal's Central Rastra Bank Law states that until or unless a firm has 1 krore ($200,000) paid up capital, it was sanctioned to make only two types of investments, hire purchase and industrial loans. Hire purchase loans were for 5 lac ($10,000) or less, while industrial loans charged 18.5% interest.

Sushim thought to himself, "This provides an even more compelling reason to increase capital quickly."

Raising Capital

Sushim, eager to share his discovery, quickly moved to lobby the Directors individually to take prompt action on this issue. To his alarm, Sushim discovered that four months prior the Board had already agreed to collect the outstanding 50% unpaid capital and issue another 20 lac ($40,000) of Right Shares, but nothing had been done since then. Increasing capital had been agreed upon in principle, but nothing would move forward until full consensus was reached by all Directors.[16] It seemed the Company Secretary was the key opponent of this plan. It took four months to persuade him and several other Directors that the additional capital was vital. Without any further delays, the earliest possible date for issuing Right Shares or collecting paid up capital was January, five months away.

In addition to the internal problems, Sushim discovered an external constraint affecting the capital issue. Clear lines of division between the Nepal Stock Exchange (NEPSE) and the Securities Board were not in place. The NEPSE claimed a new prospectus was not needed to issue the 20 lac Right Share. Meanwhile, the Securities Board said it was needed. The Chairman requested the Company Secretary and Executive Director collaborate to resolve the matter. On his own, the Company Secretary sent a letter asking for clarification. Quietly, the Executive Director boasted that he could resolve the whole problem more effectively than the Company Secretary by making a single phone call. It was on that occasion that Sushim first noticed the animosity between the two men.

January 1995

As predicted, WFS was close to deposit saturation by the end of January, pressuring the Board to reach consensus. It was decided first to call for the 50% paid up capital

from existing shareholders and then sell the new right shares. Luckily, the Chairman deposited his portion of the capital before leaving on a month-long holiday, giving the WFS some breathing room to issue loans. The next task was sending a collection notice to the 1,500 shareholders. Sushim assumed the stockholders mailing list was computerized and that it would be just a matter of affixing labels to envelopes. He later learned that, while there was a database, it had not been updated for a year. Four staff members worked four hours overtime everyday for three weeks to send out handwritten notices. During this time, the Executive Director threatened to fire half the staff when they asked for an increase in overtime pay. Several days without electricity (the line had been cut while placing a telephone line) left the office at a standstill which allowed the entire staff to pitch in and finish the project.

Shortly after sending out the requests, the market tumbled.

"The Kathmandu Stock Market witnessed a downward trend last week sending shock waves across the investor community. But looking at the sensitive nature of the market, it is not clear whether it is the political change or other facts that caused the panic."[17]

NEPSE had been bearish for the prior few weeks. The average daily turnover dropped from NRs.2.3 million to 1.46 million in the first two weeks of the newly elected Communist government. However, WFS experienced an even more severe drop in share value. Its stock fell from NRs.350 to 110 during this time. The Chairman, puzzled by this turn for the worse, asked Sushim his view. Hardly an expert of the stock market, Sushim answered, "It looks like a scare. Somehow the shareholders are misinterpreting the reason for our request for capital."

Sure enough, after talking with the head of the NEPSE, it was revealed that even the stockbrokers thought WFS was short of cash. The share price balanced out after the Central Bank restrictions and regulations were explained to the public and stockbrokers: WFS was simply growing and it needed to increase paid up capital to expand. This was the first time that the year-old stock market had experienced a call for capital, as all other firms listed had 100% initial paid up capital.

Loan Recovery Dilemma

The drop in share price refocused Sushim's effort on ensuring a fair return on investment to shareholders. WFS's image could not afford another year in the red given the Central Rastra Bank intervention and the first year's loss. The Chairman was concerned about the lack of profitability as the AGM was scheduled to be held soon. Other finance companies were rumored to be giving large dividends. He turned to Sushim for advice: "I just don't understand. Where is all their profit?"

Exhibit 7

WFS LOAN RECOVERY PROCEDURES

Prepared and translated by WFS Staff and Directors

(1) Statement to the client three days or more prior to installment due date.

(2) Three days grace period for payment of the installment.

(3) Phone call to the client after seven days.

(4) Initial letter to the client after eight to sixteen days.

(5) Will accept written explanations between 15 days and a month to establish cause of delinquency. Rescheduling of payments considered in certain cases.

(6) Second letter after 45 days stating, "If payment is not received in ___days then WFS will begin procedures to repossess the goods (vehicle, equipment)." Personal visit to defaulters will take place during this time.

(7) If WFS has received no response from the defaulter, then assistance from the police will be requested in capturing the goods.

(8) Third letter after 60 days stating, "WFS will publish your name in the Gorkha Patra (local newspaper) for the recovery of all payments." At 75 days, WFS will publish the notice in the paper.

(9) If WFS has received no response after 90 days, then after consulting with the police and other concerned parties the company will take the case to court.

(10) One copy of these regulations will be posted in the WFS office and given to each client.

Sushim suggested that WFS's woes might lie in its high default rate. The Chairman asked Sushim to investigate and prepare a plan of action in coordination with the Loan Officer. What were the reasons behind WFS's consistently high default rate? The target default rate was three percent, but rates had risen to 6.5% in the last few months. Sushim began his research with a review of the current loan recovery procedures (Exhibit 7).

After comparing the written procedure with the actual process, Sushim concluded that the majority of the problems stemmed from (a) inconsistent client contact, and (b) legal difficulties in collecting the collateral or guarantee.

Legal Constraints

Nepal's weak legal and judicial systems prevented efficient collection of outstanding debt. In addition, the lack of a Bankruptcy Act inhibited the financial sector and other creditors from pursuing and collecting from nonpaying large, small and micro-enterprise clients. These restrictions limited expansion and risk-taking activities of financial firms.[18] Large state-owned banks were not alone in encountering difficulties with debt collection. Over 60 percent of WFS's clients used land as collateral. Legal collection was very costly and lengthy, taking anywhere from one to five years to settle a case in court. Another constraint was that the land could only be claimed when the land was up for sale. In Nepal, family land is rarely sold as extended families live together for generations at the same location.

There was a real need for Nepal's authorities to implement financial guidelines suggested by the Bank of International Settlements (BIS) for loan and capital requirements. The lack of standards forced private banking and finance firms to introduce their own standards, causing greater confusion. The bureaucracy supporting this system effectively resisted the collection of outstanding loans. Limited manpower was available to perform the detailed procedures involved in recovering collateral. Even after consulting with officials at Central Rastra Bank regarding the procedures for recovering collateral, the proper steps remained unclear to the Loan Recovery Officer of WFS.

With long-term defaulters, police involvement was necessary to repossess goods or collateral. The problem lay in identifying individuals in the police force who were willing to take responsibility. Unofficial sources quoted the standard rate for this assistance at NRs.1,500 per client. No collection agencies existed, so paying a fee for these services appeared practical. Even if the police reclaimed the collateral, typically a motorcycle, WFS would then be in the business of reselling the used bikes. With no storage facilities or manpower to manage such an operation, repossession made little sense. From Sushim's point of view, police payments constituted bribery, and they were not the most suitable option. To date, WFS had not pursued this course of action against any defaulting borrower, for two reasons: concern about retribution and the desire to maintain "good" relations with the client. Direct confrontation was generally not preferred in Hindu society. Sushim was concerned that cultural norms and not profitability were driving WFS's loan recovery policy.

Logistical Constraints

While the Loan Officer was explaining the recovery procedure, Sushim realized that he had grown accustomed to Western business standards during his five years in the United States, and he was now overlooking basic logistical problems. For example, the first step in loan recovery was to call the client within one week after default. However, only 65% of the customers actually had access to telephone service. In addition, the office phone frequently was out of order for several weeks at a time. When the phone did operate, Radio Nepal was heard over the line, making communication difficult. An additional phone line had been requested a year ago, but it was not expected anytime soon.

Sushim and the Loan Officer believed the sooner the defaulters were contacted, the better the chance of recovery. Instead of calling defaulters during the first week following a missed payment, on average 50% of defaulters were called after a month.

The second step in the process was to contact the client by mail. The government was behind in assigning street addresses to homes and only 30% of the defaulters had mailing addresses.

The third step was to visit the client, but without a house address, the supervisor would spend hours locating a client. Contrary to loan recovery policy, personal visits targeting 75% of defaulters occurred approximately four months after the default date. In the end, half of the customers were eventually contacted, but only 20% made partial payments.

Before Sushim's arrival, the Loan Officer had sent a proposal to revise the loan recovery policy, but no action had yet been taken. The Board's Loan Recovery Subcommittee responsible for these issues had not met for the last two months to discuss the issue. Between the winter hours[19] and scheduled brownouts,[20] it was difficult to organize a meeting.

Annual General Meeting Preparations

There was another urgent matter for the Board to consider: the upcoming AGM. The annual meeting had already been postponed several times, and as the date approached several stockbrokers lodged complaints and threatened trouble if WFS delayed the AGM again. Legally, WFS had another month, six months after the fiscal year ended, to hold the AGM. Sushim was responsible for organizing the event, and he was becoming concerned that the true facts about the firm's financial position would not be presented. After reviewing the balance sheet with the Accounts Officer, Sushim learned that the report included accrued income but not accrued expenses. The Accounts Officer agreed the current balance sheet was not an accurate statement. Even one of the Directors had requested information on the accrued interest expense, but to no avail. The Executive Director would not allow accrued interest expense to be includ-

Exhibit 8

AUDITOR'S COMMENTS ON THE BALANCE SHEET*

* Author's note: This statement was translated from Nepali into English by a Kathmandu translator. Inaccuracies in grammar and word usage reflect his limited command of English.

Account Comments

1. Income last year was on a cash basis but this year on an accrual basis.
2. Equal interest in every month by calculating interest in initial loan amount.
3. Loan provision is not adequate with only 1% held for bad debts and no debt is written off.

Classification and Provision for Loan:

Classification and provision for outstanding loan has been done according to this:

Loan Classification	Loan Outstanding	Bad Debt Provision
Good	NRs.2,64,05,142	NRs.2,69,667

According to Rastra Bank direction and my own opinion, above classification and provision for bad debt should be like this:

Loan Classification	Loan Amount Outstanding	Percent	Bad Debt Provision
Good	2,30,89,541	1	2,30,895
Less Good	32,89,611	10	3,28,961
Doubtful	13,740	50	6,870
Bad	12,250	100	12,250
Total	2,64,05,142		5,78,976

We request an additional NRs.3,09,309 be set aside for Bad Debt Provision.

Fixed Assets

4. a) Depreciation in vehicle is according to the income tax act.

   b) No depreciation in those assets added in this fiscal year.
5. According to the decision of the first AGM, NRs.2,27,142.90 is transferred to due account from pre-operational cost and the rest pre-operational cost.
6. 20% of deposits are held in 5 year "double your money" account. None of the accrued interest expense is being included.

Deposit

At the end of the fiscal year 1993-94, the company had the following deposits:

Fixed deposit	NRs.	2,08,22,331
Pre-interest posting deposit		54,46,001
Recurring deposit		10,37,323
	NRs.	2,73,05,654

Out of the above deposit schemes there is no interest expense listed for recurring and pre-interest deposit schemes. We request the firm to provide_____. Without listing the amount of accrued interest expense, the Profit and Loss statement will not reflect the company's actual position.

END OF AUDITOR'S REPORT

ed on any balance sheet given to the Board. As a result, profit was always overestimated, placing the Executive Director in a better position.

The Executive Director wanted his form of accounting to be used for the Annual Report. At this time the internal and external auditors discovered the miscalculation and a debate ensued. Several items stirred controversy between the Executive Director, the auditors and the Officers. The biggest concern was the 54 lac interest expense due in three years.[21] The Executive Director argued not to include the expense in his version of the balance sheet, implying a meager profit on the income statement. The auditors and Officers believed these costs must be included. The auditor's comments are detailed in Exhibit 8.

NOTES

1. This case was written by Catherine Rothenberger of the American Graduate School of International Management (Thunderbird). It is intended as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

2. Deposit mobilization means soliciting individuals and firms to deposit their surplus money in fixed deposits.

3. Nepali Holidays: *Dashain* and *Tihar*, which generally fall in October and November, are the biggest holidays in Nepal. During this time, employees are given a month's wages in bonus and most people return to their family village to celebrate. For many this journey takes several days each way and offices and businesses are closed for up to two weeks.

Dashain is the truly national festival of Nepal. It symbolizes the victory of Lord Rama over Ravan. The whole festival lasts ten days. The first nine days are devoted to worship of Goddess Durga Bhanvani, and during this period buffaloes, goats and chickens are offered in sacrifice. On the last day, the elders give *tika*—a blessing to their junior family members. Thousands of people line up to receive *tika* from the King and Queen.

Tihar comes just two weeks after Dashain. The festival lasts five days and is marked by worship of the crow, dog and cow. During the five days, homes are lit by tiny lamps and electric lights. On the last day, sisters show their affection towards their brothers by performing a *puja* and feeding them food while praying for their long life.

4. There are approximately 50 Nepal rupees (NRs.) per US$1. One lac equals 100,000 rupees or about $2,000, so 340 lac = $680,000 and 8 lac = $16,000.

5. Nepal's Central Rastra Bank is the equivalent of the U.S. Federal Reserve Bank.

6. 1 krore equals 100 lac (written as 1,00,00,000), worth approximately $200,000.

7. Mathema, Vijaya Ram, "Nepal's Banking Industry," *Rising Nepal*, 5 May 1995, p.4.

8. World Bank Report, "Nepal: Fiscal Restructuring and Public Resource Management in the Nineties." Manila, Philippines: Asian Development Bank, 1994.

9. Yogi, Bhaarigrath, "Booming Business," *Spotlight*, 11-17 November 1994, p.10.

10. On November 15, 1995, Nepal held national elections. The United Marxist Leninist (UML) party received the majority of votes. After a month, a coalition government was finally formed. Though Communist in name, UML claimed to support continued private sector efforts to develop Nepal. "The Communists have promised to be good and protect democracy and capitalism while emphasizing social programs." ("Not Very Royal," *Economist*, 19-25 November 1994, pp. 31-32.)

11. Yogi, Bharigirath, "Taking Stock," *Spotlight*, 17-23 February 1995, p.12.

12. The seven member Management Committee comprised of all Officers and Assistant Supervisors. The Accounts Officer was the Convener and Secretary.

13. WFS was eligible to offer two types of loans: hire purchase and industrial. The Board decided against industrial loans because they reckoned the profit margin was not high enough, a decision that would later be changed. They only offered hire purchase loans, of which over 50% was to individuals purchasing motorcycles. Motorcycle firms in Kathmandu were unable to offer financing and they looked to the new finance companies to supply credit to customers.

14. Although there is socialized medicine in Nepal, the quality and availability is far below Western standards. Private medical facilities were preferred over public hospitals.

15. According to the Finance Company Act of 1985, Nepal Rajapaa, Vol. 35, No. 30A (E), Chapter 4, "Arrangements relating to Shares and Capital," #21 (7) Aswin 23, 2042: "The paid-up capital of the Company must be at least 10 percent of the total amount to be received through deposits, debentures, loans, and mobilization of other resources."

16. In traditional Nepali culture, even though a decision may have general approval, no concrete action can be taken until *all* participants unanimously support the decision. Voting is not a favorable alternative because the dissenting voters and the Chairman would lose face.

17. Yogi, Bhagirath, "Struggling to Recover," *Spotlight*, 16 December 1994, pp. 9-10.

18. Devres, "Mid-term Evaluation of the Economic Liberalization Project (ELP)," 5 August 1994, p. 40.

19. From mid-November to mid-February, government and most businesses close early by an hour or two due to short days and cold weather. Many homes and offices do not have heat in temperatures that drop to freezing. In addition, transportation was severely limited at night.

20. During peak evening hours, electricity was on a load sharing basis. Twice a week, every neighborhood would be without electricity for two to three hours.

21. To attract deposits, WFS initially offered a five-year deposit which would "double your money." The campaign was successful and 54 lac was deposited. These deposits represented approximately 20% of WFS's total deposits.

22. WFS was eligible to offer two types of loans: hire purchase and industrial. The Board decided against industrial loans because they reckoned the profit margin was not high enough, a decision that would later be changed. They only offered hire purchase loans, of which over 50% was to individuals purchasing motorcycles. Motorcycle firms in Kathmandu were unable offer financing and they looked to the new finance companies to supply credit to customers.

Hot Breads[1]

Kathmandu, Nepal

"Yes, yes, I've heard all of your arguments and you do have points. However, we must protect our procedures and our recipes," Mr. Sharma insisted. "If we hire locally, the workers will leave us after we have trained them and they will sell our secrets to our competitors. No, we must wait for Madras to send us more people." Mr. Sharma, the owner-manager of the most successful bakery in Kathmandu, was adamant about waiting for new Indian bakers to be assigned to Nepal, even though he was a bit unsure of himself. He sat at one of the tables in his store, discussing the most pressing problem of the moment—their shortage of trained bakers—with two of his executives.

"But we have been waiting more than two months, ever since Ramesh and Ali went back home. My bakers are complaining about the long hours, the customers are complaining that quality is down and that bread comes out later and later every day. We have to do something." Shubash, the executive chef, himself from India, was no less adamant and quite sure of himself, though of course he would eventually say, "Yes, sir," or risk continuing the conversation indefinitely. Mr. Sharma was unlikely to fire or even reproach him for his dissent; it was more the boss's style to wear down any opposition until the rebel agreed just to end the discussion.

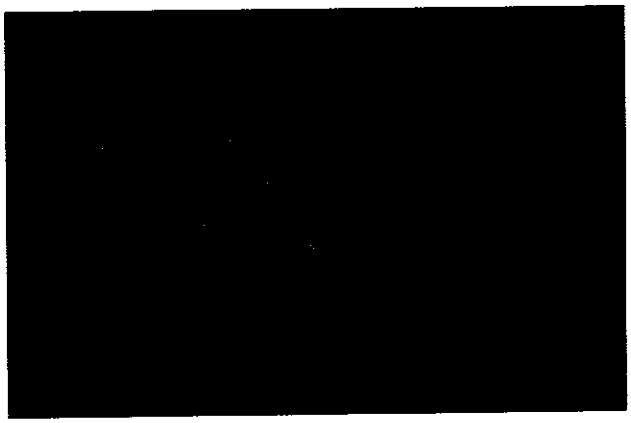
"I realize that, of course. I will call Madras again soon, tomorrow perhaps," Sharma continued. "They have been very busy, but I am sure they will send us people as soon as they can spare them. You can manage for now, Shubash."

Subha Ratner, the customer service manager and the third member of the meeting, had been sitting quietly ever since he presented his argument some time ago. Realizing that once again they would take no action toward solving their ongoing problem, Subha had allowed himself to become absorbed in what was happening at the counter. The driver was preparing to make his second delivery to the local supermarket (because not enough products had been ready in the early morning to fill their daily order). He excused himself to supervise more closely. Shubash used the interruption to check on the kitchen. All three men knew that they would have to have another meeting on this issue tomorrow—and every day—until it resolved itself, so this meeting's sudden breakup was not unexpected or problematic.

Background on Nepal and Kathmandu

The Royal Kingdom of Nepal is a small country in South Asia, sandwiched between powerful China and India. It is perhaps best known for its geography. The southern part of the country is flat and formerly a malaria-ridden jungle, a place where princes and Maharajas hunted tiger. Prince Siddhartha, the Buddha, was born here. The northern regions are dominated by Himalayas, including Mt. Everest, the tallest mountain in the world. The land in between, the "Middle Hills," harbors Kathmandu, Patan and Bhaktapur, cities that were once important stops on trade routes out of China, as well as home to numerous Hindu shrines. These hills are home to another source of Nepali fame: the Gurka soldiers of

Exhibit 1
MAP OF NEPAL



the British army. Famous for their bravery and toughness, they were recruited from the mountain villages of Nepal.

The Gurkas are not the only resilient inhabitants of this country. Hardship, in fact, is a way of life for most Nepali citizens. The country has the distinction of being among the five least developed countries in the world. The estimated per capita annual income is only US$160. Ninety-one percent of Nepal's population is involved in agriculture, most as subsistence farmers. Many of the children, especially the daughters, of these farmers work rather than attend school and as a result the literacy rate is a paltry 40% (while literacy among women is only 25%). These conditions shorten the average life expectancy of Nepali men to 54.4 years, and women to 51.6 years.

Nepal is a country of extremes, and at the other extreme of the social spectrum is the elite, the former ruling classes. These few control most of the money in the country. They are concentrated in the capital city, Kathmandu. Their children are educated abroad, in Delhi, London and the United States. They, along with the diplomats and the expatriates from various international aid agencies, give Kathmandu its unusual style, distinct from the poverty of the rest of the country.

Now, however, a middle class is emerging in Kathmandu. Domestic workers in expatriate homes, staff of various embassies, tourist and "trekking" guides and porters, carpet weavers and handicraft producers are developing wealth formerly unknown to their castes. This middle class, comprising less than seven percent of the population, who work in manufacturing and service industries, is causing a change in the country. They have created a market for education, which entrepreneurs are more than happy to fill.

They also demand a more representative government. Nepal has been a constitutional monarchy since 1990. However, the Congresses have been supremely ineffective, leading the King to dissolve them repeatedly and call for new elections. The middle class is beginning to develop a taste for luxuries—imported fabrics and medicines, foods tasted in expatriate kitchens and movies and music from foreign countries. Nearly all of Nepal's imports come from India, its neighbor to the south.

Nepal's ties with India are stronger than just economic. Nepal is the only official Hindu state in the world, and about 80% of the population practices Hinduism. Many major Hindu shrines are located in Nepal, making it a pilgrimage spot for India's Hindus. Nepali, the official language of Nepal, is similar enough to Hindi that Nepal's cinemas feature Hindi movies and much of the populace understands and can communicate in Hindi.

The Hindu caste system is perhaps more salient in Nepal than in India. The prejudices that accompany the caste system are an omnipresent and socially acceptable aspect of everyday life in Nepal.

Hot Breads

Hot Breads was the brand name of an Indian organization based in Madras. The company produced European quality pastries, both sweet and savory, and breads and cakes.

The bakers (breads and pastries) were required to go through a rigorous training procedure in Madras. Training lasted from three months to one year, depending on the needs of the organization and the potential of the individual, and included general instruction on ingredients and baking techniques as well as specific recipes (confectioners, the men who baked the cakes, were trained in Calcutta). Bakers were then assigned to stores, where they continued learning as apprentices. A French baker visited each store at least once a year acting as a consultant, evaluating the baked goods, making suggestions and teaching new techniques.

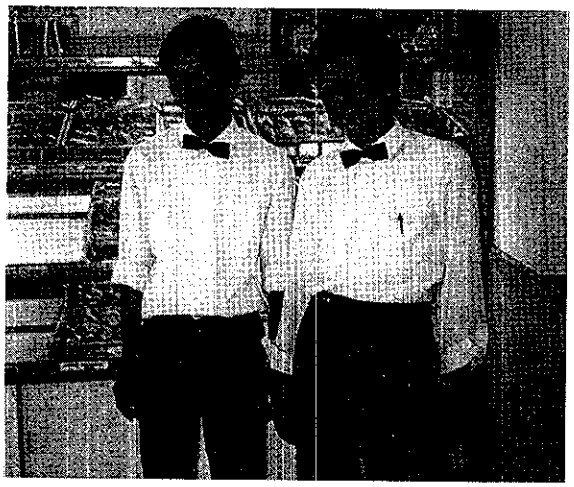
The Hot Breads organization had stores in major cities all over India and was investigating possible new locations in Dubai and various African cities. The Nepal outlet is actually a franchise of the organization. Mr. Sharma, a Nepali, bought the exclusive right to use the Hot Breads logo in Nepal and set up a limited partnership which he called Himalayan Health Foods. Himalayan Health Foods pays a monthly royalty fee to use the Hot Breads brand name. They purchase certain supplies, including chemicals and packaging materials, from the parent organization, and receive consultation visits, advice and similar forms of support.

Himalayan Health Foods and Its Founder, Sharma

The advice component was very important here, as prior to starting Himalayan Health Foods, Sharma had

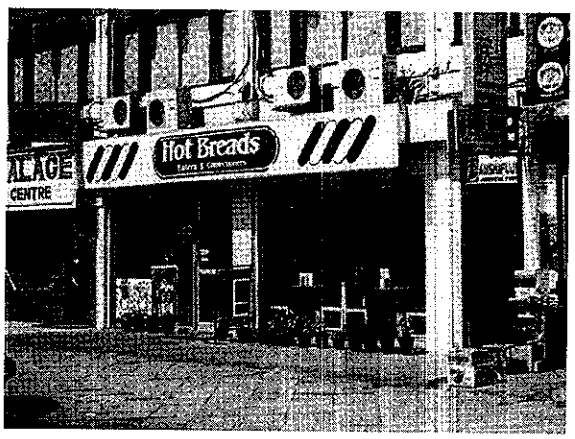
Exhibit 2

PORTRAIT OF HOT BREADS AND KATHMANDU

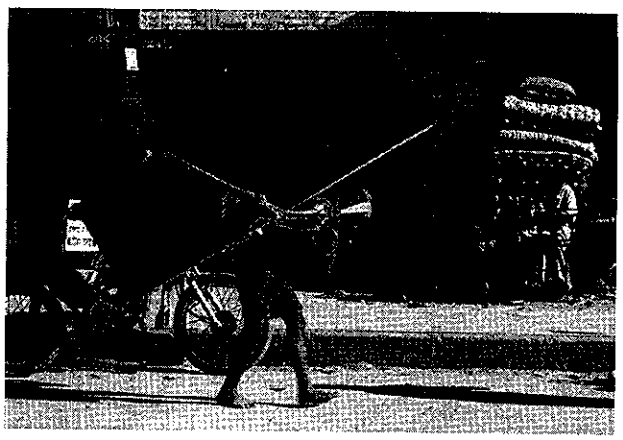


Two waiters in front of bread rack in Hot Breads store

Vegetable vendors in Kathmandu



Hot Breads store front, Durbar Marg, Kathmandu, Nepal



Delivery man

no experience in bakeries, or indeed in the food industry at all. He was an economist, a former Fulbright awardee to Cornell University and a former UN consultant. Friendly and urbane his English was flawless. He belonged to a wealthy, powerful Brahmin family. As was traditional in Nepal, the Sharma family stored most its wealth in land and consequently had large holdings in Kathmandu. The family owned many Western-style (and therefore luxurious) homes, which they rented to expatriates from various aid organizations.

Sharma sensed a change was underway in Nepal, however slow in coming. The social atmosphere was gradually shifting from unquestioning worship of the monarch to a more democratic ideal. To date, the Congresses had been supremely ineffective, but they were learning, and people continued campaigning for representation. In its periodic elections, the country enjoyed universal suffrage for those 18 years or older. They provided pictures on the ballot to accommodate the illiterate. More and more government-controlled businesses were being privatized, a movement encouraged by the aid agencies that were a significant source of funds for the government. (Aid agencies contributed in excess of US$286.5 million in 1990, or 40% of the government's total expenditures.) The government further bolstered new enterprises by offering them a five year tax holiday. Financing for new ventures was becoming more readily available, as banks loosened their lending regulations and the number of private finance companies increased monthly. Stocks in approximately ten companies were traded publicly, and Nepalis with a bit of discretionary money were enthusiastic, albeit somewhat unsophisticated, investors.

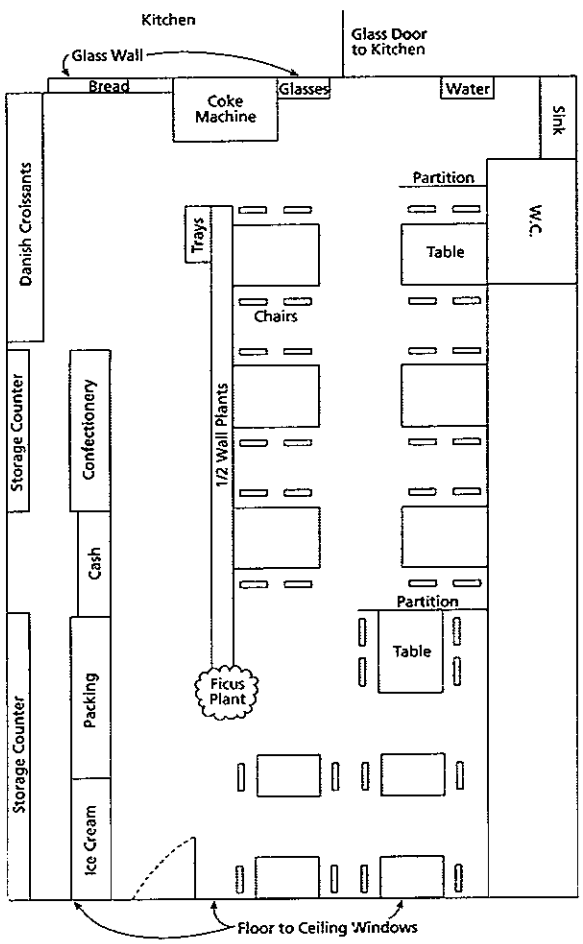
Interestingly, many of the entrepreneurs taking advantage of this atmosphere were not native Nepalis but Indian immigrants. In Nepali culture, family and religious obligations were much more important than business. As a result, Indian entrepreneurs dominated the private business scene. This caused a lot of resentment among the Nepalese. Sharma was careful to distance his business from the Indian organization even though he capitalized on their superior recipes and technical training.

Hot Breads Bakery, Kathmandu

A consequence of this distancing was that Nepali Hot Breads developed its own unique floor plan. Although most of his bakery and confectionery items mirrored those sold in Indian Hot Breads outlets, Sharma had different ideas for the presentation of breads and pastries. The usual Hot Breads formula called for breads and pastries to be kept behind the counters. Shoppers would tell a counter person what they wanted; he would then package it and tell the cashier what to charge. Sharma conceived of a new plan: a self-service area where customers could deliberate over their purchases without delaying others. In Hot Breads Kathmandu, customers used tongs to select items from attractive racks of baked goods, then carried their purchases to the counter where the cashier totaled their bill while a counter person packaged their selections.

Exhibit 3

FLOOR PLAN OF HOT BREADS



In addition to the takeout bakery, Hot Breads Kathmandu also had a full service restaurant, serving sandwiches and pizza in addition to baked goods and tea and soft drinks. Finally, the shop featured an ice cream counter equipped to serve sundaes as well as dishes and cones. The back wall of the shop was all glass, exposing the ovens and the counters where the bakers worked so that customers could see the condition of the kitchen. Other rooms in the kitchen area housed the confectioners, the sandwich grill, the bread cooling/slicing area, the staff kitchen and the storeroom. The executive office was in another building behind the shop. Located as it was in the most expensive rent area in Kathmandu, Hot Breads made careful use of space.

The staff was an odd mix of Indians and Nepalese. The bakers were all South Indian, trained in Madras and sent to work in Kathmandu. The confectioners were North Indian, trained in Calcutta. All others—the waiters, cashiers and counter attendants, the bakers' helpers and the cleaners—were all Nepalese, most of them natives of Kathmandu. This made for an awkward working atmosphere in Nepal's extremely caste-conscious society. Differences in skills and in social castes created a pecking order that was frequently contradictory as well as counterproductive.

Finally, caste traditions caused another oddity for the organization. Both Sharma and Subha were Brahmin. Strict, practicing Brahmins were restricted in what foods they could eat, where and in whose presence they could eat, and by whom the food could be prepared. Though both men tasted the foods produced in the bakery, they seldom ate there and never took food home to their families. The rest of the staff similarly restricted their diets; most ate only traditional food provided by the staff cook. As a result, taste-testing and suggesting new products was done almost exclusively by customers.

Business as Usual

Apart from these difficulties, businesses in Kathmandu faced myriad crises. Electric power was unreliable, even with the expected load sharing (planned blackouts in different areas of the city during peak usage times). Supply lines were even less dependable, and on more than one occasion essential ingredients were held in customs for months. Time and strategic "gifts" eventually got them released, but due to storage conditions,

Exhibit 4

AVERAGE MONTHLY SALES

Year	Month		Average Daily Sales Total	Bakery
Opening	1994	Feb	13,562	7,866
		Mar	30,622	15,005
		Apr	28,996	13,918
		May	31,107	14,931
		June	24,897	14,938
		July	27,001	15,931
		Aug	39,521	20,551
		Sept	55,743	26,199
		Oct	60,142	25,861
		Nov	57,614	25,350
		Dec	52,882	25,912
	1995	Jan	47,203	26,906
		Feb	45,968	24,823
		Mar	49,925	22,966
		Apr	46,111	18,906
		May	37,565	14,275

many of the shipments were unusable when they finally did arrive. Local supplies were difficult to obtain with certainty, and their prices varied widely. As a result, Hot Breads was forced to carry large inventories of their most essential ingredients. At one time, for example, they had a six-month supply of margarine.

To complicate matters further, the staff was capricious, particularly during the major holidays. Because of difficulties traveling around the country, staff members who returned home for holidays might return a few days or even a few weeks later than expected. Since Nepal has an inordinate number of holidays—the country celebrates Hindu holidays with week-long vacations, recognizes Buddhist holidays in similar fashion, and accommodates the important holidays of its numerous ethnic groups with additional days off—erratic absences could become a major disruption.

Equipment posed another problem, since the ovens, mixers and other special equipment were all imported. Repairing them and finding spare parts was a monumental task. These and other obstacles were dealt with somewhat haphazardly; management addressed them when they occurred, when they threatened the business, or, in the worst case, when they became big enough to overshadow all other concerns awaiting their attention.

Today's Crisis

The priority of the moment was a nagging production issue. Although within a month of its opening, Hot Breads had had a full complement of trained bake staff—ten Madras bakers assisted by three Nepali helpers—over time those numbers dwindled to just six bakers. For the South Indians, Kathmandu's climate, particularly its winters, was practically unbearable. Many found the separation from their wives and families difficult. The Nepali dislike of Indians was another sore point. These and other factors led to several bakers ending their contracts early, leaving the bake staff with a skeleton crew. For the past two months, this crew had been forced to work 11- and 12-hour days, seven days a week, to keep up with demand. Morale was low, quality was substandard, and the bakers were reporting for work later and later each day. This last trend was having a direct effect on sales.

Because of the unusual composition of Kathmandu's population, Hot Breads' customer base was about 45% local Nepali, 30% expatriate and 25% tourist. Nepalis generally shop in the afternoons and early evenings, buying bread for the next day. Expats and especially tourists more likely visited the shop in the morning, buying bread for the day or eating in the cafe. Unfortunately, because of the bakers' late starts, very few products were ready when the shop opened at 8 a.m. Croissants and Danish were often not ready until 10 a.m., and breads did not come out of the ovens until 2 or 3 p.m. Consequently, foreign shoppers were often disappointed in the selection of goods available when they stopped in. In fact, a marketing survey showed that while many expats regarded Hot Breads' products superior to those of competitors in the city, they shopped there infrequently because of the irregular selection. The survey indicated that expat and tourist demand might increase by as much as 50% if more product was available before noon.

Although Subha, the customer service manager, was already aware of this issue, the results of the marketing survey made it much more salient in Sharma's mind. Evidence of a real loss of sales elevated this baker understaffing problem that Shubash (executive chef) had complained about for some time from a mere annoyance—("You can manage, Shubash," was his favorite refrain)—to a genuine crisis requiring immediate attention. In a series of meetings, the three men discussed possible solutions to the matter.

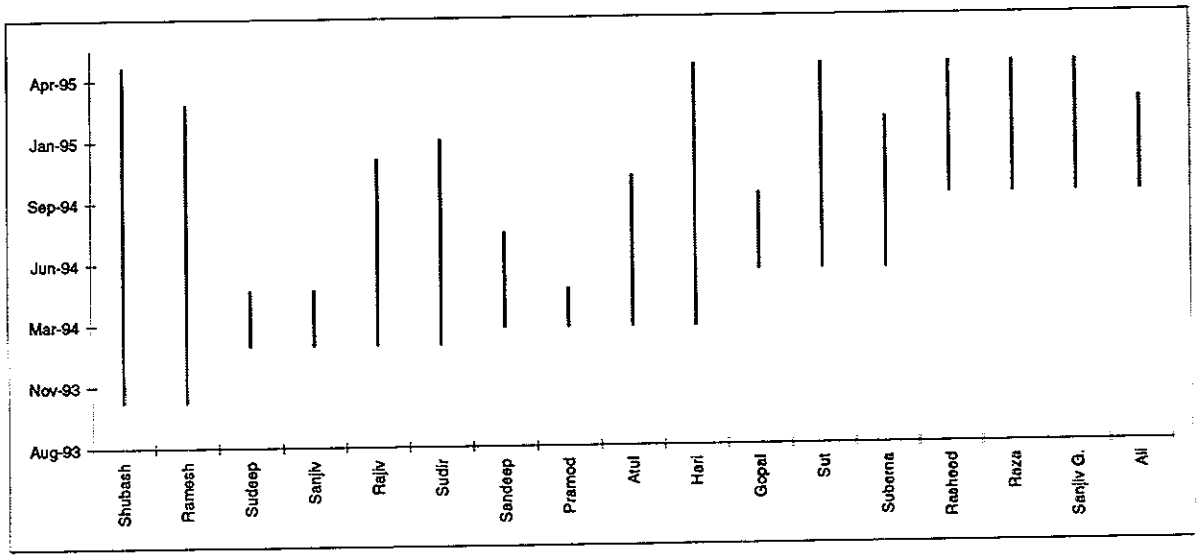
"I have some friends who are bakers in the Annapurna Hotel and the Everest Hotel (two five-star hotels in the city). Perhaps I can persuade them to leave the hotels and come to work for us. We could offer a lead baker

Exhibit 5

INDIAN BAKERS AT HOT BREADS, KATHMANDU

Arrival and departure months for bakers from Madras, India

Name	Shubash	Ramesh	Sudeep	Sanjiv	Rajiv	Sudir	Sandeep	Pramod	Atul	Hari	Gopal	Sut	Subema	Rasheed	Raza	Sanjiv G.	Ali
Arrival	Nov-93	Nov-93	Feb-94	Feb-94	Feb-94	Feb-94	Mar-94	Mar-94	Mar-94	Mar-94	Jun-94	Jun-94	Jun-94	Oct-94	Oct-94	Oct-94	Oct-94
Departure		Mar-95	May-94	May-94	Dec-94	Jan-95	Aug-94	May-94	Nov-94		Oct-94		Feb-95				Mar-95



position a slightly higher salary than they make now, maybe two weeks off for the Dasain holidays. Hiring them could solve our production problems immediately." Subha, himself highly skilled, knew skilled service people all over the city. Various friends of his had been helpful in solving past crises.

"They will have different methods, different recipes. My bakers will not work for Nepalis, and certainly not for Nepalis who have not been Hot Breads-trained," Shubash declared.

"We could set up a separate night shift, all Nepali or all Indian, to produce breads and pastries for the morning," Subha answered.

"Himalayan Health Foods cannot afford to pay the salaries they will expect," Sharma said. "The Indian bakers accept a much lower salary." For Sharma, committing money for anything other than capital investment was painful. "Besides, if we teach them our recipes, then they will go to work for someone else, or for themselves, selling products exactly like ours."

Because Hot Breads was such a success in Kathmandu, imitators were a serious concern. Nepal had very lax copyright laws and a host of people ready to copy any enterprise that was successful. A rival bakery had already surfaced, and the shop was laid out just as Hot Breads; it even had the words "Hot Bread" incorporated into its sign. Customers at the Hot Breads bakery frequently asked about the "other Hot Breads outlet" farther down the street. Since only Hot Breads recipes and techniques set Sharma's operation apart from imitators, he was very protective of them.

Shubash again advanced his plan. "We must recruit new, unskilled local workers. We can subject them to a trial phase, where they work as helpers and do not learn recipes. Then if they perform adequately, we can teach them as apprentices." Shubash had suggested this solution several times before.

"But the time that will take . . . " Subha worried.

"That is why we must start immediately," Shubash snapped.

"No, I do not trust Nepali workers. They do not work as hard as Indians," Sharma lamented. "They will learn what they need to know and then they will leave to work for someone else, or they will ask for more money. Madras must send us more bakers." Rightly or wrongly, Sharma was convinced that Nepalis would betray him.

"Sir, we asked for help three months ago, then two months ago, then again last month," Shubash reminded him. "The Hot Breads organization is expanding so rapidly that there simply are not enough trained bakers to go around. When they do finally get here, we have no assurance that they will have had any more than the most basic training. Worst of all, given our past experi-

ence, half of them will decide they cannot live here and will go home, requiring that Himalayan Health Foods pay travel expenses for yet another person. We must begin to become more self sufficient."

Shubash and Subha had previously discussed the situation at length. Though they had different solutions in mind, both agreed that waiting for help from the Indian organization was untenable. Since he was not Nepali, Shubash found it easier to disagree openly with Sharma.

"Yes, yes, I have heard all of your arguments, but . . . " The discussion broke off once again as each turned his attention to the immediate demands of operating the store.

Exhibit 6
HOT BREADS EXPENSES
March 1995

		Sub-Totals
Salaries		**82,950 RPS**
Professional Staff	14,300 RPS	
Bakery (Bakers and Helpers)	23,100 RPS	
Confectionery	11,700 RPS	
Cooks	9,900 RPS	
Service	22,300 RPS	
Utility boys	1,650 RPS	
Rent		**60,500 RPS**
Durbar Marg (shop)	45,000 RPS	
Thamel (apartment housing	15,500 RPS	
Indian personnel-- 10000 + 500/man)		
Royalty		**154,768 RPS**
Grindleys (Loan)		**135,420 RPS**
Utilities		**40,554 RPS**
Electricity		
Durbar Marg	20,216 RPS	
Thamel	750 RPS	
Gas		
Durbar Marg	15,203 RPS	
Thamel	225 RPS	
Water		
Durbar Marg	1,500 RPS	
Thamel	35 RPS	
Phone	2,625 RPS	
Suppliers		**462,595 RPS**
Bhat Bhateni	112,062 RPS	
Nirmal	24,500 RPS	
Rhabi Bhawan	150,365 RPS	
Dairy	90,850 RPS	
Bluebird Supermarket	45,183 RPS	
Hot Breads Corp.	39,635 RPS	
Services		**1,700 RPS**
Laundry Service	350 RPS	
Tailor (uniforms)	500 RPS	
Artist (sign)	850 RPS	
Travel		**14,780 RPS**
Cab in city	350 RPS	
Ramesh (one-way passage to Madras)	7,215 RPS	
Ali (one-way passage to Madras)	7,215 RPS	
Misc.		**6,000 RPS**
Gasoline	4,000 RPS	
Medicine (for Shubash)	2,000 RPS	
TOTAL EXPENSES MARCH 1995		**959,267 RPS**

Exhibit 7
BAKERS' SALARIES

NEPALI RUPEES

Baker	Current Monthly Salary	Comparable Nepali Salary
Shubash	3,000	4,500
Ramesh	2,800	4,500
Hari	2,500	3,500
Sut	2,500	3,500
Rasheed	1,600	2,500
Raza	2,500	3,500
Sanjiv G.	2,500	3,500
Ali	1,600	2,500
TOTAL	19,000	28,000
Average	**2,375**	**3,500**

NOTES

1. This case was written by Julia Kreisinger Henker of the University of Massachusetts. It is intended as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.