CASE: 1
LAMPERT & SONS COMPANY (30%)

John Lampert, president of Lampert & Sons Company, a small manufacturing firm producing electrical appliances, was an entrepreneur with a technical background. He recently moved into a new house, and his wife asked him to install some spotlights to accent various areas in the house, such as bookshelves, a sculpture, and certain items in a wall unit.

At the local lighting stores, the lamps that might fit the purpose cost far more than Mr. Lampert was willing to pay. He felt that there was a real need for a low-cost, attractive spotlight or clamp-on lamp. He discussed his idea with a business colleague, who raised a number of questions such as these:

- Is there really a need for such a product?
- What should such a lamp look like?
- How or where should it be produced (e.g., in his plant in the Midwest or abroad, such as in Korea, Hong Kong, or Taiwan)?
- What arrangements would have to be made if the lamp were to be produced by Lampert & Sons?
- What kind of distribution channel (or channels) should be used to sell the product?
- How would he maintain the quality if the price of the lamp was to be kept low?

After this discussion, Mr. Lampert realized that he really had not thought through his idea and could not satisfactorily answer several of the questions.

1. If you were a small-business consultant, how would you answer the questions Mr. Lampert's colleague raised?
2. What other actions would you recommend for making the decisions to design the product, to set up a production system, and to control the operation, especially the quality?
3. What decision-making tools and techniques could assist in making these decisions?

CASE 2

WILLINGHAM COURSES, INC.

Capital Budgeting: Basic Techniques

< 30% >

Willingham Courses, Inc., founded by Ron Willingham in 1972, has dealt primarily in personal and professional motivational courses, particularly for corporate employees. Most recently, the firm has focused on development material to be used to prepare a company's sales force to be more effective in their efforts.

At the present time, extensive thought and effort have been given to developing a new sales program. The course material, titled *Integrity Selling*, provides an approach to selling based on a clear identification of the customer's legitimate needs. Willingham has identified a strong potential market for such a course among the Fortune 500 firms to be used in training their sales personnel. In visiting with the sales executives of several of these companies, he has received commitments to purchase the course. However, he is reluctant to begin selling the program before investigating the merits of the two possible strategies. Specifically, questions still remain concerning the expected life of the instructional material and the marketing strategy.

In analyzing the prospects of the investment, Willingham considers the basic product to have an expected life of approximately five years (Strategy A). However, this estimate could be significantly lengthened by undertaking a major revision in the course package in the fifth year (Strategy B). The options under consideration may be summarized as follows:

- *Strategy A:* The first strategy requires an investment at the present time totaling \$300,000. This amount would provide the necessary funds for course development and production equipment (\$250,000) as well as working capital requirements of \$50,000. The working capital portion of the investment may be liquidated upon the termination of the course. The expected life of the project is five years.
- *Strategy B:* The second strategy involves a two-phase investment in which the initial investment of \$350,000 is committed (\$250,000 in course development and equipment plus \$100,000 of working capital), but \$200,000 must also be expended on course development at the conclusion of the fifth year. This investment would result in substantive modifications and improvements in the program. While time is of the essence in going to the market, within the next few years several major improvements in educational equipment are expected. Such a two-phase investment would allow the firm to reap the benefits of these developments.

To sum up, the management is considering two basic approaches for promoting *Integrity Selling*: (1) a concentrated effort whose intent is to saturate the market during a five-year period (Strategy A); (2) an extended investment in *Integrity Selling* with the prolonged life being the result of a major revamping of the course structure in the fifth year (Strategy B).

The estimates of the annual receipts and operations expenses for the two strategies are given in Figure C22-1.

Additional information relevant to the situation is as follows:

Figure C22-1 Ron Willingham Courses, Inc. Estimated Annual Receipts and Operational Expense

Year	Sales: Plan A	Sales: Plan B
1	\$100,000	\$ 75,000
2	300,000	125,000
3	450,000	200,000
4	450,000	280,000
5	450,000	350,000
6		475,000
7		500,000
8		500,000
9		500,000
10		500,000

Year(s)	Marketing Expenses per Year: Plan A	Marketing Expenses per Year: Plan B
1–5	\$ 35,000	\$ 25,000
6–7		25,000
8–9		25,000
10		25,000

1. The production of the material will require the use of a portion of an existing plant not included in the cost of the investment. This part of the plant, which represents excess floor space, could be considered to have a book value of $150,000 and a corresponding annual depreciation of $10,000 per year. However, this segment of the plant is not used presently and could not be used otherwise, owing to the floor plan of the building.
2. Cost of goods sold of similar programs has generally been a variable cost approximating 60 percent of sales.
3. Administrative expenses for the company will be $10,000 annually, which has been the level of administrative expenses for the past year. However, only $4,000 of this amount will be allocated via the cost accounting system to the new program.
4. The bank has agreed to finance $100,000 of the investment at an interest rate of 10 percent, with the interest being payable yearly and the principal coming due at the end of the project life.
5. The company's tax rate is 30 percent, and it uses straight-line depreciation (no salvage) for all expenditures. Assume that the cost of course development, equipment and plant expenditures will be depreciated over the life of the project, while the cost of the working capital is not depreciated, but any working capital will be recovered at the end of the project.

Questions

1. Compute the annual after-tax cash flows for the two plans.
2. Compute the net present value and the internal rate of return for each plan, assuming a cost of capital of 12 percent.
3. Which course of action should be taken by the firm? Explain.

Case III. Book-of-the-Month Club (40%)

ONCE a pioneer in book distribution, the 60-plus-year-old Book-of-the-Month Club (BOMC) had fallen on hard times. BOMC's outdated production methods forced the club's editors to choose their titles 13 weeks before catalogs reached members. In today's publishing environment, 3 months often mean the difference between the best-seller list and the remainder bin.

Although BOMC's database contained 3.5 million memberships in the eight book clubs BOMC runs, the database was not a gold mine of information. It retained names, addresses, and the number of books ordered—very basic information. But it retained little data about a customer's tastes and preferences.

Prospecting for new members had also become prohibitively expensive. BOMC relied on no-commitment offers such as "four books for four bucks," with no pledge to buy more. Thus many new members never ordered anything else. BOMC became a commodity merchant whose basic pitch was price. But it could not effectively compete on price with nationwide chains such as Waldenbooks and B. Dalton.

BOMC recently started making some changes. Gone from its advertising is the hard sell, in favor of a gentle pitch with the theme "We deliver more than books." Ads still push cheap books, but now they insist on a commitment to buy two books at the regular price. The company also highlights services such as gift wrapping and book searches. The unmistakable message: Join for the privileges of membership, not for the cheap books.

Some 400,000 long-standing repeat buyers have been designated "preferred members." They receive specially designed book catalogs and mailings and have access to a special 800 order number. The feedback has been so positive that BOMC plans to roll out preferred member status to another 600,000 customers.

Desktop publishing and other technologies have been adopted to reduce editorial lead time from 13 weeks to 3.5. But the biggest hopes for progress rest on better use of the club's database. Unlike the old system, the new one spits out all sorts of facts on exactly what BOMC members read. Does a member of the History Book Club buy only books on ancient Greece? Does a member balk at paying more than $12 for a single title? On the basis of this kind of information, BOMC will be able to target its marketing efforts and catalogs much more narrowly.

The new database should also help BOMC control marketing costs. For example, if a member historically buys only two or three books a year, there's no point in mailing a new catalog every 3 or 4 weeks.

QUESTIONS

1. Why do people buy books through the mail?
2. How important to BOMC's success is its marketing database? Explain.
3. Is BOMC practicing frequency marketing? Explain.
4. Does BOMC do a better job of targeted marketing now than it did in the past? Explain.