

CASE 3

Everyone Does It

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JIM WILLIS WAS THE VICE PRESIDENT OF MARKETING AND SALES FOR INTERNATIONAL Satellite Images (ISI). ISI had been building a satellite to image the world at a resolution of one meter. At that resolution, a trained photo interpreter could identify virtually any military and civilian vehicle, as well as numerous other military and non-military objects. The ISI team had been preparing a proposal for a Japanese government contractor. The contract called for a commitment of a minimum imagery purchase of \$10 million per year for five years. In a recent executive staff meeting, it became clear that the ISI satellite camera subcontractor was having trouble with the development of a thermal stabilizer for the instrument. It appeared that the development delay would be at least one year and possibly 18 months.

When Jim approached Fred Ballard, the President of ISI, for advice on what launch date to put into the proposal, Fred told Jim to use the published date because that was still the official launch date. When Jim protested that the use of an incorrect date was clearly unethical, Fred said, "Look Jim, no satellite has ever been launched on time. Everyone, including our competitors, publishes very aggressive launch dates. Customers understand the tentative nature of launch schedules. In fact, it is so common that customers factor into their plans the likelihood that spacecraft will not be launched on time. If we provided realistic dates, our launch dates would be so much later than those published by our competitors that we would never be able to sell any advanced contracts. So do not worry about it, just use the published date and we will revise it in a few months." Fred's words were not very comforting to Jim. It was true that satellite launch dates were seldom met, but putting a launch date into a proposal that ISI knew was no longer possible seemed underhanded. He wondered about the ethics of such a practice and the effect on his own reputation.

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The Industry

Companies from four nations—the United States, France, Russia, and Israel—controlled the satellite imaging industry. The U.S. companies had a clear advantage in technology and imagery clarity. In the United States, three companies dominated: Lockart, Global Sciences, and ISI. Each of these companies had received a license from the U.S. government to build and launch a satellite able to identify objects as small as one square meter. However, none had yet been able to successfully launch a commercial satellite with such a fine resolution. Currently, all of the companies had announced a launch date within six months of the ISI published launch date. Further, each company had to revise its launch date at least once, and in the case of Global Sciences, twice. Each time a company had revised its launch date, ongoing international contract negotiations with that company had been either stalled or terminated.

Financing a Satellite Program

The construction and ongoing operations of each of the programs was financed by venture capitalists. The venture capitalists relied heavily on advance contract acquisition to ensure the success of their investment. As a result, if any company was unable to acquire sufficient advance contracts, or if one company appeared to be gaining a lead on the others, there was a real possibility that the financiers would pull the plug on the other projects and the losing companies would be forced to stop production and possibly declare bankruptcy. The typical advance contract target was 150% of the cost of building and launching a satellite. Since the cost to build and launch was \$200 million, each company was striving to acquire \$300 million in advance contracts.

Advance contracts were typically written like franchise licensing agreements. Each franchisee guaranteed to purchase a minimum amount of imagery per year for five years, the engineered life of the satellite. In addition, each franchisee agreed to acquire the capability to receive, process, and archive the images sent to them from the satellite. Typically, the hardware and software cost was between \$10 million and \$15 million per installation. Because the data from each satellite was different, much of the software could not be used for multiple programs. In exchange, the franchisee was granted an exclusive reception and selling territory. The amount of each contract was dependent on the anticipated size of the market, the number of possible competitors in the market, and the readiness of the local military and civilian agencies to use the imagery. Thus, a contract in Africa would sell for as little as \$1 million per year, whereas in several European countries \$5–\$10 million was not unreasonable. The problem was complicated by the fact that in each market there were usually only one or two companies with the financial strength and market penetration to become a successful franchisee. Therefore, each of the U.S. companies had targeted these companies as their prime prospects.

The Current Problem

Japan was expected to be the third largest market for satellite imagery after the United States and Europe. Imagery sales in Japan were estimated to be from \$20 million to \$30 million per year. Although the principal user would be the Japanese government, for political reasons the government had made it clear that they would be purchasing data through a local Japanese company. One Japanese company, Higashi Trading Company (HTC), had provided most of the imagery for civilian and military use to the Japanese government.

ISI had been negotiating with HTC for the past six months. It was no secret that HTC had also been meeting with representatives from Lockart and Global Sciences. HTC had sent several engineers to ISI to evaluate the satellite and its construction progress. Jim Willis believed that ISI was currently the front-runner in the quest to sign HTC to a \$10 million annual contract. Over five years, that one contract would represent one sixth of the contracts necessary to ensure sufficient venture capital to complete the satellite.

Jim was concerned that if a new launch date was announced, HTC would delay signing a contract. Jim was equally concerned that if HTC learned that Jim and his team knew of the camera design problems and knowingly withheld announcement of a new launch date until after completing negotiations, not only his personal reputation but that of ISI would be damaged. Furthermore, as with any franchise arrangement, mutual trust was critical to the success of each party. Jim was worried that even if only a 12-month delay in launch occurred, trust would be broken between ISI and the Japanese.

Jim's boss, Fred Ballard, had specifically told Jim that launch date information was company proprietary and that Jim was to use the existing published date when talking with clients. Fred feared that if HTC became aware of the delay, they would begin negotiating with one of ISI's competitors, who in Fred's opinion were not likely to meet their launch dates either. This change in negotiation focus by the Japanese would then have ramifications with the venture capitalists whom Fred had assured that a contract with the Japanese would soon be signed.

Jim knew that with the presentation date rapidly approaching, it was time to make a decision.