

PART I: COMPREHENSIVE CASES

Case 1 *An Ethics Role-Playing Case: Stockholders versus Stakeholders*

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Instructions to Students:

Please read the background information (Handout I) and be prepared to discuss it on the assigned class day. Then **read Handout II and write out your Decision 1 and answer the questions.** After these discussions your instructor will provide you with further handouts requiring sequential decisions resulting from your Decision 1.

HANDOUT I. INTRODUCTION AND BACKGROUND²

You are a United States citizen employed by HotFeet, a Seattle-based and U.S.-owned shoe company that manufactures many of its shoes overseas. You live in Sri Lanka and work at the wholly-owned subsidiary located there, Asian HotFeet (AHF). You have been employed by HotFeet for twenty years. For fifteen of those years you have lived in Sri Lanka, and for the last five years you have been AHF's Chief Operating Officer. You were hired by George Landon, who is now the president of the company. The two of you continue to have a good relationship, and you play tennis together whenever he visits. Landon's personal loyalty to you has positively affected your career at several critical points, and you know you owe him a lot. You are married to a local who has extensive family, many of whom are directly or indirectly employed by your company. You have three beautiful children. You are quite proud of your family and enjoy your lifestyle very much. A major part of your satisfaction is derived from the knowledge that your company's presence has greatly benefited the local populace. This is, in no small part, because of your efforts to ensure fair treatment of local workers and maintain a high level of reinvestment in the country whenever possible. Because of this, and because of your local connections through your spouse, you are a highly esteemed individual in Sri Lankan society. Although you are still a U.S. citizen, you have begun to notice that you really don't think of yourself as an American anymore. You know that the home office gossip is that you have "gone native," but that's OK with you, because you have no aspirations to move back to the U.S., or live anywhere else for that matter.

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² All students should receive Handouts I and II. They should receive the appropriate versions of Handouts III, IV, and V depending on their decisions. Detailed instructions appear in the Instructor's Resources.

Asian HotFeet is owned and officially run out of the parent company's Seattle headquarters (USHF), but in reality you have significant leeway in running local operations as long as you meet the company's profit expectations. AHF comprises about 15% of the total operations of USHF, and so this subsidiary is a very important strategic investment for the parent company. The subsidiary is evaluated as a profit center; about 60% of output is sold directly by AHF in the Asian markets, but the remainder is "sold" to the parent at a transfer price set by the parent company. Traditionally, the transfer price has been set fairly high to keep the profits in Sri Lanka, which has a lower tax rate than the United States. USHF then directs how the profits are reinvested around the world and in Sri Lanka, with your consultation on local projects. Long-term financing and foreign exchange management are, however, centralized functions managed directly by USHF. You have little experience with either large scale financing or measuring and managing foreign exchange risk, although you have lobbied many times for more responsibilities in these areas. AHF's profit growth was very high for many years, until the Asian crisis and the continuing weakness in Japan generated several years of losses. More recently, AHF has had acceptable levels of profits, but is now once again having difficulty meeting the profit goals set by USHF. The parent company finance group has asked you to fly to the US and discuss some changes. At that meeting, your bosses indicate that due to a combination of factors, USHF is considering either closing the AHF facility or relocating it to another country. They explain to you that the firm's cost of capital has risen, making AHF's return on investment inadequate to satisfy their goal of maximizing USHF's shareholder wealth. In addition, the firm was surprised by the recent weakening of the dollar, resulting in speculative foreign exchange losses that have exacerbated the parent firm's profit problems. More to the point, newer production technology with higher productivity and automation has recently become available, and the parent is rethinking its strategy about locating in low-cost labor areas that are far from the major markets. In addition, Sri Lankan wage rates are beginning to rise, and the cost advantages of that location are not as great as they once were, particularly considering the added costs and inconveniences of operating in a lesser developed country. Landon tells you that you would most likely be the manager of the new facility, and you would work with the finance and operations groups in determining where the new facility would be located.

You argue that AHF should not be closed or relocated, pointing out the strong, mutually beneficial relationships that have been built between the local populace, the Sri Lankan government, and the AHF—relationships that, though perhaps not measurable in dollars, are very valuable and time consuming

to build. These would be forfeited by a move or a closure and would be costly to develop elsewhere. You argue that capital costs and exchange rates are subject to frequent changes and that it is naïve to make long-term operating decisions according to what may be short-lived unfavorable interest rates and exchange rates. You indicate that “your people” can certainly be taught to use any new technology, that they are good at their jobs, and culturally they have a history of taking pride in craftsmanship that would be hard to find elsewhere. That is why AHF has a lower rejection rate and less waste than any other plant owned by USHF. You argue that the rising wage rates in Sri Lanka indicate the success of AHF and other multinationals at improving the quality of life of the local people, and you remind the home office that we are also building potential customers for our product as local incomes rise. Finally, you tell them that they do not understand the differences that businesses like AHF have made in the lives of many of the indigenous people. Education levels are starting to rise, and the use of child labor, a common practice, is dropping. The selling of children by impoverished families with no hope of feeding them has dropped dramatically in the last ten years. But all these gains are precarious, and yes, the Asian economy as a whole is still weak compared to the high-growth years, but you are convinced that better times are ahead as the Japanese and Chinese markets improve. Still, the local economy is very dependent on a few large employers, and if AHF and even one or two others leave the human cost could be high, very high indeed. How do you weigh this potential cost against the shareholder wealth goal?

HANDOUT II. DECISION 1

Landon is impressed by your passion and your arguments. He indicates that they may allow AHF to continue if you can cut costs sufficiently. The finance people are not happy with this, however, and they indicate that allowing AHF to continue at its current profit rate is tantamount to running AHF as a charitable operation, and that USHF’s substantial contributions to U.S. charities such as the American Red Cross, United Way, and so forth, will likely have to be eliminated to at least partially offset the drain on profits caused by continuing AHF. Landon is a big supporter of the Red Cross and he does not like that alternative at all.

To wrap it up, Landon lays it on the line for you. He tells you up front that he would prefer to close AHF and start

over in another country with the new technology. He explains why: USHF’s stockholders are upset at the recent poor stock performance. Shutting down and selling AHF’s assets would provide some ready cash and allow the parent firm to pay a bonus dividend to the shareholders, while still providing a sizeable down payment on the capital investment required for the new technology. Given the current economic situation and the skill level of Sri Lankans, it just doesn’t make sense to locate the new facilities in Sri Lanka. He obviously thinks this is the best thing for the company, and it would avoid a potentially serious row with the stockholders. Landon indicates, though, that if you can prove that AHF can meet the necessary profit targets, he might reconsider. If you are willing to try, you will have to figure out how to cut costs or otherwise improve profits to keep AHF running. Can you do it? He tells you he will give you six months and then reevaluate if they still want to continue. Landon makes sure you understand that this will mean reducing the work force, cutting wage rates, and trying to find lower-cost supplies without sacrificing quality.

You have looked at the finance group’s numbers and profit targets. You also know that, politically, it will be very difficult to fire or lay off people in Sri Lanka, which means that extensive wage cuts of 50% or more will be necessary. This will reduce many families to just enough income to survive. Worse, you will have to act very quickly, and your employees will have no warning of what’s coming. Even that may not be enough. Plus, you know that your reputation with Landon and the company is on the line with this decision. If you try and you can’t make this go, your career with this company will suffer and you will not only lose your shot at managing the new facility, but will probably lose your job.

Decision 1

Part A: Does this decision involve ethics or is it a business decision? Please explain. Should the shareholder wealth goal be paramount in this situation? Why or why not?

Part B: The decision is up to you. What do you do? Please circle (a) or (b).

- (a) Continue operations and try to cut costs within six months.
- (b) Decide to shut down now.

Please tell why you made the decision you did.