CHAPTER ONE

Executive Succession in a Family or Small Business: The O'Bannon Company Experiential Exercise

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Abstract

One of the most critical issues in a family or small business is executive succession: the process through which both the successor learns to lead the company and the current CEO prepares to relinquish his or her management responsibilities. The transition of power through executive succession affects everyone connected to the company, including owners, employees, other family members, customers and suppliers. Ultimately, the outcome of the succession process will determine the company's future.

This case study of a hypothetical family business focuses on the key challenges involved in executive succession. First, we summarize variables that have been found to impact an orderly transition from current leadership to the successor, such as advance planning and family conflict. Then, we present an experiential group exercise that illustrates these executive succession challenges. The O'Bannon Company scenario describes a family business confronted with the founder/CEO's sudden incapacity. The wife (and sole heir to O'Bannon), the three children, their widowed sister-in-law, and the company's banker must work with the company's Board of Directors to complete an orderly transition of power. However, because of the lack of a formal succession plan, coupled with family conflicts and differences in goals, the transition of power becomes quite complex. Using either group or role-play format, participants analyze the O'Bannon situation and propose solutions for this family and their company. We conclude with a set of recommendations (e.g., the role of outside board members) for effective leadership succession in family and small businesses.

Research Findings

Prior research has shown that only about 30% of family businesses survive from the first generation to the second (Handler, 1994). Thus, one of the biggest challenges to the ongoing future of family firms is planning for executive succession (Chua, Chrisman, & Sharma, 2003). Indeed, according to some scholars, succession may be considered the ultimate test of a family business (Gersick, Davis, Hampton, & Lansberg, 1997). Succession planning is the systematic process through which both the successor learns to lead the company and the predecessor prepares to relinquish his or her management responsibilities. Although the predecessor and successor are the two key members involved, succession transition affects everyone connected to the company, including other family members, any shareholders, employees, customers, and suppliers. Various factors, ranging from owner/manager individual characteristics to family influence and organizational characteristics, may also impact the extensiveness of the succession planning process (Davis & Harveston, 1998).

Effective succession begins with effective *early planning*. Ideally, planning is an ongoing process, with parameters updated regularly to reflect changes in business and family goals and circumstances. Family and small business owners need to realize that the unexpected can—and does—happen, and well-prepared heirs are important to successful transitions (see Morris, Williams, and Nel, 1996). First, the owner/current CEO must be willing to make and discuss succession arrangements. This step may be difficult for the classic "Controlling Owner" (Lansberg, 1999) who rarely delegates responsibility. As Hindo (2005) notes, "Indeed, what often makes the entrepreneur successful in the first place—a strong-willed, even stubborn determination—can be a serious drawback in succession planning."

The next step is to *designate a successor* through a defined transition of power. Selecting one successor, especially from siblings, presents serious dilemmas, and making an impartial succession choice may be a struggle for parent/owners. Despite family politics and birth order, the candidates must be judged on their social and leadership abilities as well as managerial capabilities; trust and dependability should be top priorities. As Lansberg (1999) notes, the selection of a successor involves assessing future business needs rather than present family politics.

Shared governance and allocating roles may be an option if there is more than one good candidate (Gersick, et. al., 1997; Lansberg's (1999) "Sibling Partnership"). For example, in Lansberg's

"First Among Equals" model, one acknowledged leader is lead manager, perhaps serving as president while the other siblings occupy seats on the Board of Directors or act as departmental heads. This model works only if the lead sibling consults heavily with his or her other siblings, builds consensus, and proves his or her management skills to the other siblings. In the "Shared Leadership" model, the siblings lead as a team. Managerial authority is divided equally, as are salaries, bonuses and perks. With this model, getting employees and the outside world to understand and work with the shared leadership arrangement is often a critical challenge (Lansberg, 1999).

Even a well-articulated succession plan cannot avoid another challenge of transitioning power: conflict within the family. In some cases, the "generational shadow" cast by the owner/founder (Davis & Harveston, 1999) leads to disagreements; in other situations, different points of view among siblings are hard to reconcile. Furthermore, emotions may run high, intrafamily power struggles may occur, and coordinating the input of multiple family members may be time-consuming and frustrating (Lansberg, 1999). Because of the intersection of family and business issues, conflict management is critical to family firms. Sorenson's research (1999) suggests that integrative *conflict management* strategies such as collaboration produce better outcomes than more adversarial strategies. *Communication* is another essential requirement for effective family and small companies (Gersick, et. al., 1997; Davis & Harveston, 1998). For example, family meetings may be useful both to share important information as well as to defuse potential conflict.

Family and small businesses often *enlist outside help* to assist with the complex issues of succession planning (Hindo, 1995). A competent group of external advisors, such as an active board of directors, offers balance and perspective that is hard to achieve with insiders alone. The perspective of company employees who are not family members must also be addressed; research has also shown that relationships with nonfamily members are critical to an effective executive succession process (Chua, et. al., 2003). One caveat about the importance of outside advice is offered by Gersick et al. (1997): They suggest that the company's lawyer and accountant should not be members of the board, as their positions as paid advisors may create a conflict of interest.

The O'Bannon Company Exercise

We created the O'Bannon Company Exercise to illustrate the challenges of executive succession in family and small firms. The experiential exercise uses a hypothetical small family business called O'Bannon. All participants read the exercise scenario, which describes the company's background and the recent sudden incapacity (severe heart attack) of O'Bannon's founder and CEO, Walter. There are six potential successors to Walter: five family members and one non-family member. Participants are cast as the external advisors on the firm's Board of Directors and asked to:

- analyze the impending changes at the O'Bannon Company
- choose the successor to replace Walter
- provide recommendations for the long-term survival of this firm

The exercise is suitable for any training session or class involving family or small businesses. We have used O'Bannon in multiple graduate management (MBA) courses (Organizational Behavior, Organizational Change and Development, and Human Resource Management), in classes ranging in size from 20 to 45 students, as well as presenting at a conference to receive colleagues' feedback (Reilly, et. al, 2007). If desired, a second scenario can be added to the exercise, in which Walter does not suffer a heart attack, but instead announces his decision to retire in five years. The participant teams' succession plans and recommendations are thus quite different.

Exercise Implementation

The O'Bannon exercise may be implemented as a standard experiential group exercise, with each participant group preparing its own analysis and recommendations. Alternatively, the O'Bannon scenario can also be adapted into a role-play exercise with six characters (with six participants per group, corresponding to the six successor candidates). If the exercise is used with the role-play format, it is also important to spend some time emphasizing the technique of role playing and staying in-role. Groups may be formed by participant preference, by proximity, or by facilitator assignment.

Implementing O'Bannon takes from 60 to 90 minutes, as outlined below. When time is at a premium, it is also possible to have the groups conduct the main portion of the exercise outside of the class or training session. Please note that Exhibit 1 includes both "O'Bannon Company Overview" and "Profile of O'Bannon Company." The exercise's essential components are included in the

"Overview," but if more detail is desired, the "Profile" section may also be used. During our teaching, we found that some students spent too much time sorting through the company background, and not enough time in working through the executive succession issues. So, we tightened up the company description into the "Overview," thus leaving more detail as optional with the "Profile."

In addition, the exercise may be combined with a written assignment. For example, each group may be asked to provide a written synopsis of particular features of the exercise (such as their group dynamics) or to answer one of the discussion questions presented in Exhibit 1 (such as listing the strengths and weaknesses as potential CEO for each character).

Exercise Format

I. Introduction (10 minutes). The facilitator summarizes the O'Bannon exercise parameters, and if desired, the participants may briefly discuss any prior experience with family or small business and succession planning. Divide into groups.

II. Group Work (20-30 minutes). Participants review the O'Bannon Company scenario (Exhibit 1: "Overview" is required; "Profile" is optional, as described above) and the brief profiles of the six potential successors (Exhibit 2). The Discussion Questions in Exhibit 1 should be addressed; each group should select a preferred candidate to become the new CEO of O'Bannon; and finally, each group must provide recommendations for succession planning.

III. Class Discussion and Debrief (20-30 minutes). The exercise results are shared together with all groups. The facilitator summarizes candidates chosen by each company group on a white board or flip chart, and the inevitable differences are discussed. The following lists potential outcomes based on our teaching experience with this exercise:

- the most frequently chosen successors to Walter are Wally, Jr. or Erin
- recognizing the potential for conflict between Wally, Jr. and John, some groups have proposed a family or business mediator; others have suggested that Katie step in as peacemaker
- Katie has been designated interim CEO until a permanent successor is chosen
- groups who chose Wally, Jr. as the new CEO sometimes propose Matthew as Wally, Jr.'s successor.

Exhibit 3 provides a table summarizing the strengths and weaknesses of the six potential CEO candidates. This table, which utilizes prior student groups' analyses, may be used as a teaching note to supplement the O'Bannon exercise debriefing. Exhibit 4 highlights recommendations for the O'Bannon Company's future, to be offered during the debriefing session and supplemented by class discussion.

Exercise Outcomes

Our classroom experiences with O'Bannon have been very positive. One measure of student involvement is that few groups finish the exercise before the allotted time expires. Sometimes, impasse about successor choice occurs, which is a good segue into the role of an outside advisor to help with conflict resolution. The exercise debriefing generates a lively discussion about the individual attributes and leadership talents of the potential successors, the organizational culture of the O'Bannon Company, and recommendations for the firm's future. We believe the analyses reported in Exhibit 3 and the recommendations summarized in Exhibit 4 also illustrate their learning outcomes about effective leadership and the importance of succession planning.

Student evaluations of the O'Bannon exercise have been collected as part of regular end-of-term course evaluations. Students consistently rank this exercise positively (between 4 and 5 on a 5-point Likert scale). We asked a recent Human Resource Management MBA class (n = 19) for some specific feedback after completing O'Bannon during class. Ninety-five percent of the students agreed the exercise was interesting; 74% considered it helpful to their learning about executive succession; and 79% agreed it was useful in understanding organizational change. The students provided numerous written comments as well, including: "A relevant and helpful exercise"; "This exercise showed the difficulty of choosing a successor"; "Realistic scenario—made me think what would I do, really"; "Overall, this was GREAT. Thank you!"

Recommendations

Exhibit 4 lists our recommendations for effective leadership succession in family and small businesses. These recommendations acknowledge the key role of leadership succession in the long-term survival of a small or family firm. As Lansberg notes, "Governance structures in family companies must be designed to safeguard the long-term interests of family shareholders by ensuring the growth and continuity of the enterprise and promoting the family's harmony and welfare." (1999:281).

Exhibit 1: O'Bannon Company Overview [Required]

The O'Bannon Company is an import/export firm founded 35 years ago in a large Midwestern city by Walter O'Bannon, now aged 63. As a self-made man, Walter valued education, hard work, and determination, and his dream was to start a business that could be passed down to future O'Bannons. He started small by using family ties to import products from Ireland. Over time, Walter's patience and persistence moved the O'Bannon Company into new European markets, and now this family business has grown to 94 employees, with sales last year of $78 million. However, Walter's strengths lay in the day-to-day administration of O'Bannon, not in strategic planning, including looking ahead to the inevitable transition to the next generation.

Most of the O'Bannon Company employees work in the warehouse or as sales and service representatives. O'Bannon employees are not unionized, and many have worked at the company for ten years or more. Labor relations are quite good. O'Bannon family members presently involved in the business are:

- President and CEO Walter O'Bannon, Sr., company founder
- Executive Vice President Walter, Jr. (Wally, Jr.), Walter's second son
- Vice President of Sales and Marketing John O'Bannon, Walter's third son

Walter's daughter, Erin, does not currently work at the company. Robert O'Bannon, Walter's oldest son, was the firm's "heir apparent" before his untimely death several years ago. Robert's widow, Julie, and their two children live nearby.

Walter, Sr. built up much of the firm's customer base during the company's early years. Wally, Jr. focuses on the operational side of the business, and the sales force of 10 representatives, overseen by John, cultivates customer contacts. While O'Bannon has enjoyed steady growth and profitability since its founding, the past five years have seen increased competition and changes in merchandising associated with on-line purchasing. Wally, Jr. would like to push O'Bannon into new markets, perhaps through exploring strategic partnerships; John is comfortable with the status quo, as is Walter.

Profile of O'Bannon Company (Optional)

Founded:	35 years ago
Headquarters:	Large Midwestern city
Sales, most recent fiscal year:	$78 million
EBITDA, most recent fiscal year:	12%
Sales growth, past five years:	3% annually
Employees:	94, as noted:

- Management team: 7, including three O'Bannons:
  - Walter, President and CEO
  - Wally, Jr., Executive Vice President
  - John, Vice President of Sales and Marketing
- Warehouse Personnel: 37
- Regional Sales Representatives: 10
- Customer Service Staff: 9
- Procurement and Quality Assurance: 12
- Clerical, Accounting, and All Others: 19

O'Bannon's warehouse personnel are non-union, primarily because the company offers generous benefits and competitive pay. Many of the long-term warehouse employees enjoy a good relationship with Walter O'Bannon, and they also respect Wally, Jr. because at one point he worked alongside them in the warehouse. While John is loved by his high-performing sales and marketing staff, he is resented by some employees in other departments for being frequently out of the office, playing golf and entertaining clients.

Customer contacts are cultivated by the sales force of ten regional representatives as well as by John himself. Nearly forty percent of the O'Bannon Company's sales are to Fortune 500 companies. The other sixty percent of sales comes from a myriad of small-to-medium-sized businesses that have grown weary of O'Bannon's competitors, most of whom are subsidiaries of large corporations.

The company's vendors are primarily in Ireland, Scotland, and England, but Wally, Jr. and the firm's German-born purchasing manager initiated a push into Central and Eastern Europe about five years ago. During this time, the O'Bannon Company locked up some dependable vendors who have resisted price increases and maintained high quality standards, thanks to Wally, Jr.'s tough but fair-minded approach. In addition, Walter's long-term personal contacts in Ireland and the U.K. have contributed to the many strong relationships with the firm's vendors.

The company has a long-standing banking relationship with a local institution, Fourth Second Bank. Walter O'Bannon has been fiscally conservative, using the firm's line of credit only to fund inventory purchases. Wally, Jr. has been pushing for more expansion into new markets in response to increased competition and on-line purchasing options. He believes capital expansion could easily be funded with a term loan from Fourth Second Bank, or through exploring strategic partnerships with other firms. However, to date John has sided with Walter in resisting any plans for changing the O'Bannon Company.

Current Situation

After a lifetime of excellent health, unfortunately Walter suffered a major heart attack last night. His prognosis is good, but Walter has finally realized the time has come to retire. His doctors have forbidden Walter from working for at least six months, and given his frail health, Walter decides he is too close to his family to make the difficult decision about his successor. Others will have to choose. The most recent document addressing company ownership is dated 1980, in which Walter wills all his assets (including the firm) to his loving wife, Katie. No other provisions have been made for the company, the children, or the grandchildren. In order to maintain the stability of the O'Bannon Company, a successor to Walter must be named immediately. Since a succession plan is not in place, the Board of Directors of the O'Bannon Company now finds itself in an emergency Board Meeting to select the next CEO of the company.

Group Exercise Task

You and your group members comprise the external members of the O'Bannon Company's Board of Directors. Given Walter's sudden heart attack, you must (1) assess the company's current position, then (2) review the O'Bannon family members' credentials and choose a successor to the company. Be prepared to explain the merits of your chosen candidate as to why he/she should be the new CEO. You may assume that each of the six potential successors would be willing to assume leadership of the company, and thus would accept the offered position as CEO. When making your decision, remember that the outside world must feel comfortable with this choice, as it will impact the financial and organizational future of the company.

Be prepared to answer the following Discussion Questions:

1. Prepare a brief summary of the O'Bannon Company and its current situation. What are the forces pushing for change, and the resistance factors impeding change?
2. What are the strengths and weaknesses of each family member, as well as of Matthew (the outside banker), as they relate to leading O'Bannon?

3. For each of the candidates, how do you foresee the company changing if he/she is chosen to succeed Walter? How will the other family members react to the new set-up? How will each change the dynamics of the company?
4. For those candidates who are not chosen as the successor, what role do you see them playing in the O'Bannon Company going forward?
5. What recommendations can you offer about the importance of succession planning and its long-term impact?

Exhibit 2: The Six Potential CEOs

Katie: Katie and Walter O'Bannon have been married for forty years. Katie's direct involvement in the company's operations has been minimal, dropping by with the family poodle and attending the annual Christmas party, but Katie has always played the role of family peacemaker, organizer, and cheerleader. She has been a valuable listener to Walter over the years, offering many suggestions behind the scenes. Despite her eccentric flair, she loves her family and wants to see the company that Walter built survive another generation. She worries that the Board of Directors' decision could split her family apart.

Wally, Jr: While credited by outsiders with maintaining O'Bannon's solid growth, Wally, Jr. feels unappreciated and undervalued by his siblings and mother. He has worked in each facet of the company, starting with answering phones while in high school to overseeing departments while completing his degree at a local college. Wally, Jr. has subsequently moved up the corporate ladder as he has assumed more knowledge and responsibility. He is a workhorse, but is very particular about how he runs things – to the point that he tends not to take advice from others. He is clearly a task-oriented manager.

John: At John's college graduation 10 years ago, his diploma may have noted a degree in Management, but his expertise was in socializing. John also has inherited a natural talent for the family business. He has a knack for obtaining new clients and keeping them happy, usually involving numerous golf courses, expensive dinners, and ski trips to Aspen. Therefore, his time in the office is erratic, which makes it difficult to include him in meetings. Walter did not complain, however, as John "brings in the business," and John is extremely knowledgeable about O'Bannon's customer base.

Erin: Dad always encouraged Erin to follow her dreams, and she majored in finance at a prestigious undergraduate institution on the East Coast. During summers, Erin worked as her father's Administrative Assistant, but after graduation she decided to take a job as a financial analyst with a company in New York. It's not that she didn't want to work for the company business; she wanted to get out and spread her wings. Erin's motivation and drive have allowed her to move up, and after eight years, she is now assistant vice president at her New York employer. She likes New York, and only comes home at Christmas, to see the family.

Julie: Julie and Robert (now deceased) met when he was a patron of the luxury hotel where she formerly worked. Although her husband has passed, Julie is very interested in maintaining her ties with O'Bannon and her share of the company, to ensure the continuity of her comfortable lifestyle. As the mother of the only two O'Bannon grandchildren, Julie feels that any major company decisions should go through her, to safeguard the children's—and her—financial standing. Julie comes from a prominent family that owns a large conglomerate of hotels and businesses.

Matthew: Matthew has been O'Bannon's corporate banker—and Walter's personal friend—for twenty years. Although he has other clients, Matthew's commitment to the O'Bannon Company's interests has earned him the confidence of the entire O'Bannon family. They are aware that Matthew has thought about leaving the bank to run his own business, and indeed, Walter once offered Matthew a job within O'Bannon years ago. While lacking in management expertise, Matthew is financially savvy and quick to learn.

Exhibit 3: Strengths and Weaknesses: The Six Potential CEOs

CEO Candidate	Strengths	Weaknesses
Katie	• Knowledgeable about business strategies and goals (through conversations with Walter) • Able to identify strengths and weaknesses of her children	• No management experience • Strong emotional ties to "Walter's" company and to her family (could resist any needed change)
Wally, Jr.	• Motivated and skilled • Knowledgeable about overall functions of the business	• Highly task-oriented; may lack people skills • Limited interaction with and knowledge of customers
John	• Knowledgeable about the product • Strong relationships with customers	• Limited operational knowledge • Limited experience outside of Sales
Erin	• Strong educational background • Relevant outside experience	• Little direct knowledge of O'Bannon and its business • Potential conflict with Wally Jr. and John?
Julie	• Some prior management experience (hotel industry) • Connections that could lead to potential growth	• May be viewed as gold digger by O'Bannons • Limited involvement in the business
Matthew	• Fresh perspective • Has trust of entire O'Bannon family from role as advisor	• An outsider—NOT a family member • Limited management experience

Exhibit 4: Recommendations for Leadership Succession

- Don't wait until the CEO's heart attack to plan for succession
  - Some participants considered Walter a failure as a leader, because he has jeopardized his company's future with no succession planning
- A well-considered executive succession plan can stop outside rumors and questions about the company's future
- Advice and counsel from outsiders is important:
  - The company's banker, accountant, and/or attorney may be helpful
  - A Board of Directors with a majority of outsiders is a good tool
  - Psychologists skilled in family relationships can assist with family dynamics and conflict
- Even with outside consulting help, political behavior at the top—and within the family—should be expected
- Open and regular communication throughout the firm and the family is critical
- Why do many CEOs of family/small firms avoid succession planning?
  - Fear of making the wrong successor choice
  - Seek to avoid perceived favoritism
  - Concern that the successor will take over before the current CEO is ready to retire
  - Inability to give up control of the business

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Reilly, A.H., Brown, T.J., Eddy, E., Schifferdecker, J., Taylor, J., Taylor, V.K., and Mattice, J. (2007). "Executive succession in the family or small business: The O'Bannon Company experiential exercise," paper presented at the 95th annual Society for Advancement of Management (SAM) Conference, Las Vegas, NV.

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Note: *An earlier version of this exercise was presented at the 95th annual Society for Advancement of Management (SAM) International Business Conference, Las Vegas, Nevada, in March 2007. The suggestions provided by the SAM discussant and participants, by colleagues who have used this exercise, especially Dr. Dow Scott, and by students who have contributed their comments are gratefully acknowledged.*

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This case was prepared solely as a basis for class discussion and is not intended to serve as an endorsement, source of primary data, or illustration of effective/ineffective management.