Muebles Copihue, S.A.¹

TEMUCO, CHILE

CASE A

t 7:45 pm Daniel Acuña, co-owner of Muebles Copihue, S.A., and his new administrative chief, Mauricio Hermann, jumped into the back of a colectivo and headed for their 7:00 pm meeting. Daniel threw Ch\$1000 pesos to the driver (the usual fare was only \$120).² "You can have the whole \$1,000 pesos if you take us directly to our meeting on Varas Street" in downtown Temuco, Chile. The driver thought about it for a moment, then quickly diverted the colectivo from its prescribed fixed route to serve as a taxicab. "Why is it," Daniel asked Mauricio on the way, "that I am always running like this?"

I have the best of intentions, and despite my 13-hour workdays, it always seems I never have enough time to do all the things the company needs to have addressed. The urgent matters always seem to take precedence over the important ones.

For instance, this morning I was at work at 8:00 am. I conferred with the factory chief on our latest furniture projects. I reviewed these details with him three times. We were interrupted by phone calls from clients awaiting word on their orders, from the bank with questions about our line of credit, and from a supplier regarding an incorrect invoice the secretary couldn't figure out. Before I knew it, it was noon, and I still had not completed new sketches for a large made-to-order kitchen. Three employees from the plant had requests for some time off, and the veneer machine was spitting out

pieces that were way too long for the cabinet doors we were covering. My mother-in-law insisted I walk next door for a cup of coffee and some of her hot bread or *Once*,³ and my father-in-law wanted me to get him a deal on some rauli wood for the new staircase he is building.

As I finally sat down to work on the designs and sketches, I got a call from the guy who smashed into our pickup truck yesterday. He said he was trying to avoid a Mapuche Indian⁴ with a horsecart, and didn't see our pickup, so he is not going to pay for car repairs—\$400,000 pesos!!

How do other managers in rapidly growing companies juggle all this? The Chilean furniture market is hot right now, so we have to move quickly—but in which direction? How can I handle all the daily organizational details, generate sales, and do long-term planning, too?

Company Background

Muebles Copihue, S.A. (MC)⁵ was established nearly 30 years ago by the father of the current owner, Arturo Jaramillo. It was a small, privately run organization, manufacturing all types of furniture. Arturo was only moderately successful as a business person, but he established a reputation for producing a quality product. Approximately four years ago, the company was purchased by Arturo's 31 year-old-son, Osvaldo Jaramillo,

and his 27-year-old brother-in-law, Daniel Acuña. Osvaldo worked for his father in the business while growing up but in college studied Naval Engineering. He originally planned to use the plant to build small fishing boats. That turned out to be less than profitable, so he returned to furniture. Daniel was a high school teacher until his brother-in-law convinced him to join him in the furniture business. Teaching jobs were scarce, and prospects of financial success were quite limited. This convinced Daniel to make a career change.

Muebles Copihue, S.A. specialized in the manufacture, sale, and service of high-end, high-quality furniture—specifically for the kitchen, bath, and closet. Eighty percent of sales were in kitchen cabinets, both base and wall models.⁶ The remaining 20% was divided equally between vanities and closets.

The company had three main client groups: architects and construction companies building or remodeling new homes; private property owners building, remodeling or expanding existing structures; and commercial interests with a need for showcases and cabinetry.

Location

MC was located within the city limits of Temuco, in the Ninth Region⁷ of Chile, approximately 450 miles south of Santiago. Temuco is the capital of the region, and a bustling economic center for the area.

The factory was in a lower-class neighborhood, approximately two miles from downtown Temuco. Also on the grounds were two small houses. One was used as living quarters for Osvaldo's parents. The downstairs area of the other house had been converted into a furniture sales/showroom, with the upstairs being utilized as living space for Osvaldo's brother, Arturo Jr., and his family.

Population

The Ninth Region had a population of approximately 800,000 residents, with 250,000 of those living within Temuco. The population was young; 75% were less than 39 years of age. Approximately 32% of the population was Mapuche Indian. Sixty percent of the population lived in the cities, and 40% was classified as rural.

Temuco was the fastest growing city in Chile. The fifth largest in population, it enjoyed growth of 60% between 1982 and 1992. The population growth rate was anticipated to stay at 5.45% annually through the year 2000.

Temuco's growth was expected to continue due to its geographic position, only five miles from the geographic center of the region. Temuco was the obvious choice location for communications, businesses, and increasingly, services.

The growth in residents generated a need for housing. Currently, the average number of residents per living quarters was 4.88, which was 0.41 residents over the national average. The Municipality of Temuco, in recognizing the existence of a housing deficit, revised its building height restriction, allowing for the construction of no less than 20 new buildings of at least five stories in the past three years alone. Also included in the construction boom were plans for a new resort hotel on the outskirts of town and a new hospital. There was controversy in Temuco as to whether this construction growth could be sustained much longer and whether or not Temuco was already "overbuilt."

Economics of the Region

Historically, the region contributed an average of 3.3% annually to the Gross National Product for the years 1980–1990. Sources of income included fishing, agriculture, forestry, and tourism. GNP statistics for the region were somewhat skewed by the existence of "Pockets of Poverty" in regional Mapuche villages such as Saavedra, Tolten and Carahue. Carahue had the dubious honor of having the population with the highest consumption of alcohol per capita in the world.

Nevertheless, it was estimated that the economy of Temuco and the surrounding region would grow at an average rate of 3.9% annually for the next five years—up from an average of 2.3% during the 1980s. This was, in large part, a result of the growth in the forestry sector. Forestry exports in 1992 reached \$1.2 billion U.S. dollars, having quadrupled in the last eight years, and they were expected to quadruple again within the next 15 years. The Region was being transformed into a major producer of lumber and wood products with the planting of more than 230,000 hectares of pine and eucalyptus, among other species. Neither of these

woods were indigenous to Chile, but elapsed time between planting and harvest was only 20 years in Chile, as compared to 25–30 years in countries such as New Zealand, Russia, and the United States. This enabled growers to significantly decrease their production costs. Another 600,000 hectares of land were suitable and available for planting but had not yet been forested. With this shift to the forest products industry, spinoff industries such as lumberyards, furniture, and paper factories were expected to benefit.

Fabrication Process

The majority of cabinets were made of *masisa*, or strong particle board, with melamine, a vinyl material, exterior. Particle board could also be covered with a thin wood veneer of various types of wood. Doors and cabinets were made of pure wood, mainly eucalyptus and pine, but other indigenous species such as rauli, manio, and coigüe were also used.

The factory had distinct departments, and employees were not rotated among them. (See Exhibit I for a chart of the production process.) After an initial order was received and plans drafted by either the owners or the sales manager, they were given to the factory head for distribution and direction. The wood or masisa was received in large planks, which were cut in the machine shop to predetermined specifications using buzzsaws. Masisa pieces then went to the veneer department, where a machine using hot glue and thin rolls of veneer tape covered the edges and sides as necessary. After the veneer was applied, the pieces were taken to assembly. Here, predetermined perforations were made for hinges and screw attachments, and the pieces were attached into cabinet frames. At this point, the operation ceased to be an assembly line and became more "job shop" oriented. In the final process, counters and baseboards were attached. For wood products, the process was much the same, with the addition of visits to the varnish department for five coats of stain and sanding. Sanding was started with a machine but most work was done by hand-using anywhere from three to six different grades of sandpaper to obtain a smooth finish.

In reality, there was very little variation in the raw materials used in kitchen/bath/closet furniture. At MC, almost all bodies were made of *masisa* with a white

melamine exterior. All kitchen countertops were made of *postformada*, or postform, which was *masisa* with a water/heat resistant formica finish. The "custom" work came more from the type of door used and the colors of countertops and door handles selected. Doors could be made of melamine, postform, pure wood, or wood veneer—depending on the taste and pocketbook of the client.

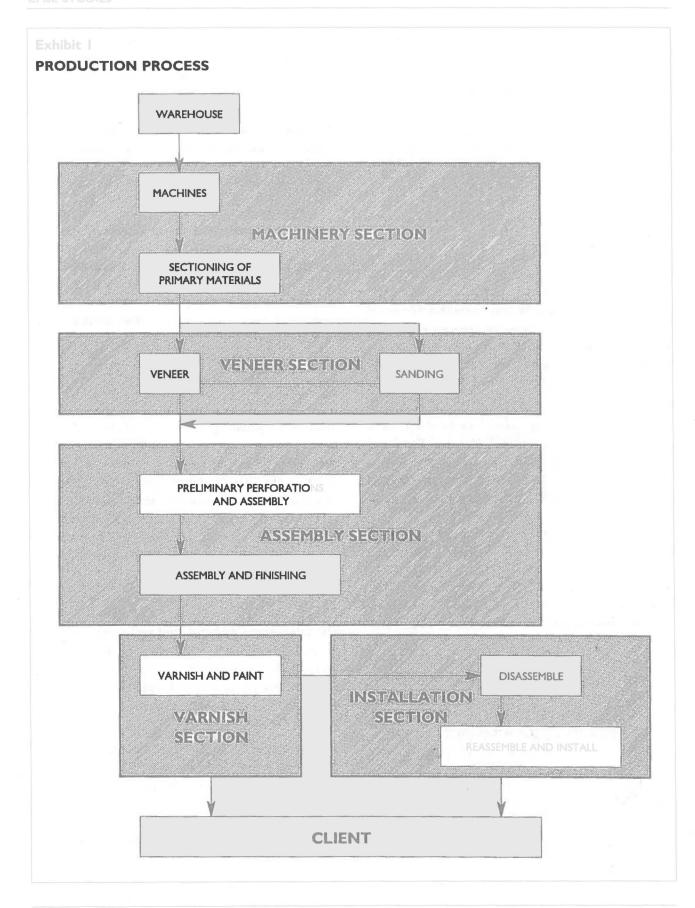
After the final stage, a team of two or three workers personally did the installation. This was always included in the quoted price. It was very important to the owners to assure that each detail was checked. Both owners spent a great deal of time with and offered personalized attention to their clients. "We offer a money back guarantee to any client who is not completely satisfied with the design, workmanship, and installation of this furniture," Osvaldo stated proudly. "So far, no one has shown any interest in taking us up on our offer. My clients have always paid their bills, so I know they must be satisfied with our product and service." Osvaldo considered sending several of his more experienced workers to plumbing school to include that service as part of the installation package. Osvaldo recently proudly hung on the office wall his certificate of completion from the Total Quality Management course he had attended in Santiago. Both he and Daniel cherished, and hoped to preserve and improve, MC's reputation for quality.

Organization

There were 43 plant employees, two owner/managers, one salesperson/manager, and two secretary/book-keepers. The position of administrative officer was only recently filled, and an internal accountant/information specialist was yet to be hired. Until then, MC utilized an external accountant and received monthly updated reports.

The majority of the factory work force was semiskilled and skilled labor. Approximately 75% had graduated from high school, and 25% had previous carpentry experience. There were at least six pairs of siblings working in the factory, as well as numerous mutual friends who had found their jobs through the current work force.

The plant workers were divided into three categories of maestros or master workers, ayudantes or helpers,



and advanced *ayudantes*. There was no formal training program for job skills; employees learned and mastered tasks through on-the-job instruction. No specific mechanism was in place to determine when or how a worker advanced, for instance moving from *ayudante* to *ayudante avanzado*. "Don Daniel will tell us when we are ready," employees typically confided. Responsibilities ranged from the routine (e.g., sanding furniture for 10 hours a day) to the varied (e.g., designing and hand-carving cabinetry, or installing cabinets in a resort hotel).

Most employees felt great loyalty to the owners, and particularly Daniel, once they had established themselves. After learning greater skills, they usually stayed for many years. Salaries and benefits were determined by Daniel based on employee experience. Monthly bonuses were awarded in much the same way—based on Daniel's perception of each person's participation and extra effort. Daniel tried to be as understanding as possible with his employees' requests for time off and salary advance—especially for those who intended to stay for the long term. However, he found the rapid jumps in the Chilean minimum wage (currently US\$100/ month) and the high inflation rate difficult to keep up with. Consequently, many of his employees with two or more years of experience were earning little more than a new hire (\$105-120/month). Current wage rates were about 50% less than at other furniture factories of comparable size in the area. Labor unions were rare in Chile, but becoming more popular since Pinochet left office in 1989.

The factory chief had started as an *ayudante* in the factory eight years ago, and had held his current position for seven years. He mainly oversaw the production process. Managerial and personnel decisions were made entirely by Daniel.

There were five women besides the secretaries working in the plant. They generally held positions of less responsibility and earned less money than the male workers because it was assumed they would eventually marry and/or have children and not need the same level of income as a man.⁹ The exception to this was Catalina Gutierrez, the head of the veneer department. Her husband had been head of that department until his untimely death at age 28 from a heart attack 18 months before. Catalina had never worked outside the

home before, but needed to find a way to support her son. Daniel offered her her husband's position and personally trained her on the machinery. Although her salary remained lower than the comparable male heads of other departments, she had been entrusted with directing the other two employees in the department, one of whom was male.

The Managers

Daniel and Osvaldo, as business partners and brothers-in-law, had a close working relationship. Responsibilities were loosely defined between the two. Both pursued sales and prepared layouts, designs, and price quotes for clients. Both utilized a "gut feel" approach to pricing and costs—they had a basic idea about production costs at the factory, and applied a 100% markup to determine client prices. A mechanism to measure exact costs was not in place, nor did they feel a need to actively establish one. "Daniel and I share the same brain," Osvaldo explained. "We don't have to talk on a regular basis, because I trust him, I know him, and whatever decision he makes, he makes for both of us. If it is a bad decision, then we go down together."

Daniel and Osvaldo were both well-known and popular about town. Both had strong, outgoing personalities, and Osvaldo, coming from a family of 11 children, had many family connections. In fact, their friends at the Bank arranged short-term lines of credit within a day as needed. Daniel's brother-in-law was the construction company executive in charge of the contract for the 23 new condominiums MC recently finished, and the largest (and only) supplier of masisa in Chile gave MC a discount that was not available to the local cooperative of 14 furniture manufacturers. Both spent a great deal of time establishing and nurturing close personal relationships with their primary business contacts. Daniel, in particular, had a very difficult time doing business with someone he did not know personally. "I have to know their faces," he often said.

Arturo, Jr. had been Sales Manager for over four years, even while his father still owned the company. His main responsibilities included attending to clients in the office, drafting designs for kitchens and bathrooms, and figuring price quotes for all custom work. He was paid a base salary plus commission for each order. He averaged Ch\$250,000 pesos a month (US\$650.00). How-

ever, he lived in the house rent free on the factory grounds, and his wife had a well-paying job as a nurse. Some afternoons, instead of doing sales calls, he helped his father down on the farm, about 30 miles outside of Temuco. They always enjoyed a particularly close relationship, especially since he was eldest son and namesake. He felt he had generated quite a bit of business for the factory, and deserved the opportunity to buy in as partner with his brother and brother-in-law, but such an offer had not materialized. So, in the meantime, he did what he had to do, keeping his eyes open for other business opportunities.

Mauricio Hermann was the newest member of the management team. He had been employed in the public sector, as an engineering consultant to a local furniture cooperative of which Daniel was Vice President. Daniel pushed very strongly to bring him aboard as Administrative Chief, without interviewing any other candidates. He even deferred the use of the psychological profile test, the latest tool to be used in the hiring of middle managers in Chile. Osvaldo trusted Daniel's instincts concerning Mauricio.

Mauricio was quite overwhelmed when he first arrived in his new position. He had not realized there were so few formal controls in place in MC, and he quickly established a method of measuring production costs and inventory control. This had met with mixed success, as the employees were not diligent about recording the time expended and materials used on each project. The owners had never formally defined any of the positions in the company, so he wanted to identify and mesh his priorities with those held by the owners.

Needs for the Immediate Future

The company all too often operated at 100% capacity. They had a steady increase in sales last year and actually turned away about 25% of the interested clients last month. Various options to increase production capacity had been considered, including double shifts. However, current workers were already working the maximum 48-hour work week, and the owners did not feel ready to train and supervise a whole new staff. In addition, space in the plant was already at a premium. Factory space would have to expand in order to store increased quantities of raw materials, work in process, and finished goods.

The owners felt an excellent option would be to purchase new equipment to fulfill current and anticipated production needs. Current equipment was adequate but outdated for the firm's needs, and could possibly be resold to a smaller factory. Daniel and Osvaldo felt they had identified the right replacement equipment, made by a Spanish company. The first machine needed was a new seccionadora, a machine that could rapidly and cleanly cut melamine planks and hardwood into desired lengths and thicknesses. The second was a new veneer machine, which could easily apply veneer of desired lengths to increased quantities of board feet. With the addition of these two machines, capacity would eventually increase 300%. Manpower currently needed to cut planks and boards would be decreased from six people to two people. There would be no layoffs, however, as personnel would be trained for other areas.

The second option was to expand the factory to provide more storage space, a new painting area, and possibly a dining/changing area for the employees. The neighbors next door to the plant expressed a willingness to sell their land for the right price.

Daniel and Osvaldo decided they needed to look closely at their financial situation to determine whether they had the capacity to support the size loan they would need, and to evaluate how they might increase sales to utilize the additional productive capacity provided by the new equipment. Through this expansion, they would establish themselves as the foremost manufacturer in the Temuco region. No other factory had the up-to-date machinery and production capacity they were contemplating. Exhibit 2 shows the costs of the new equipment investment. Exhibit 3 shows the owners' best estimate of their income statement for the past several years.

A professional business consultant was hired to assist them with the cash flow analysis and projected sales for a 10-year period. The projected sales territory included the area between Los Angeles to the north and Puerto Montt to the south, though Daniel and Osvaldo did not yet know exactly how they would pursue those markets.

Goals for the Next Ten Years

 Expand and improve the production capacity of Muebles Copihue.

Exhibit 2			
INVESTMENT IN NEW EQUIPM	ENT		
all figures are in U.S. Dollars			
I. Assets as of 1/1/93			
LIQUID ASSETS		FIXED ASSETS	•
LIQUID ASSETS Cash on Hand	\$ 7,839	Machinery	\$ 24,251
Raw Materials	27,839	Vehicles	9,794
Work in Process	39,552	Furniture	623
Other	5,262	Tools	4,195
Total	\$ 80,492	Total	\$ 38,863
	TOTAL A	SSETS \$ 119,355	
II. Cost of Investment			
A. Machinery and Equ	uibment .		
Sectioner	,	\$ 91,963	
Veneer Applicato	r	34,976	
	for above machinery		
(Spare parts and	power source)	34,884	
TOTAL		\$161,823	
B. Acquisition of Adjoining La	nd	\$ 26,315	
C. Working Capital for 90 D	ays	\$ 27,105	
III. Total Investment			
ITEM	OWN	LOAN	TOTAL
LIQUID ASSETS	\$ 80,49	92 \$ 27,105	\$107,597
FIXED ASSETS	\$ 38,86	\$188,138	\$227,001
TOTAL INVESTM	1ENT \$119,35	55 \$215,243	\$334,598

xhibit 3			
MUEBLES COPIHUE, S.A.			
NCOME STATEMENTS			
Owners' Best Estimate)			
- · · · · · · · · · · · · · · · · · · ·	1992	1991	1990
Sales	\$386,176	\$148,887	\$88,371
Cost of Goods Sold	246,808	88,405	52,529
Gross Margin	139,368	60,482	35,842
Salaries/Wages	60,032	31,997	16,161
General/Administrative Expenses	31,708	19,132	16,897
Depreciation	5,463	2,974	534
Income before Interest and Tax	\$42,166	\$6,379	\$2,250
Interest	4,874	0	0
Income before Tax	\$37,292	\$6,379	\$2,250
Taxes (15%)	<u>5,595</u>	958	339
NET INCOME	\$31,697	\$5,421	\$1,913

- 2. Operate with adequate physical space to house the new level of production.
- 3. Expand the target market, in both geographic size and socioeconomic class.
- 4. Satisfy adequately the increasing needs of a growing furniture market.
- 5. Generate a sufficient inflow of cash to recoup the investment, compensate for the assumed risk, and provide a reasonable margin to contemplate the possible reinvestment of the profits back into the company.

Osvaldo and Daniel felt they were well directed towards fulfilling Goals I and 2. Several options were being considered for Goals 3, 4 and 5. One way to go was to expand the made-to-order business by developing new outlets, selling in other regions and possibly Argentina, and expanding sales in the local area around Temuco. Another possibility involved developing a new line of standardized kitchen cabinets to be sold through major retailers throughout Chile. They considered both options.

Option 1. Market Development: Expand the Made-to-Order Business

UTILIZING OUT-OF-AREA PERSONAL CONNECTIONS

The owners had established many connections over the past few years due to their strong interpersonal skills and the quality of their furniture. Daniel had a cousin in Puerto Montt, 300 miles to the south, and Osvaldo had a sister in San Martin de los Andes, in Argentina, 200 miles to the east (see page 13 for a map of Chile). Both were eager and able to promote MC's products by word of mouth, catalog, and sample sales. An architect and friend of both owners living in La Serena, 900 miles to the north, wanted to represent their product in the homes and office buildings he designed. Osvaldo also had a sister-in-law who offered to represent their products to architects and construction companies in Chillan to the north.

Puerto Montt was a growing town six hours south of Temuco. Its primary industries were tourism, dairy products, and especially fisheries. Chile's salmon exports had grown from zero five years ago to \$300

million in 1992, making Chile the second largest exporter of salmon in the world. Puerto Montt was the major port of the south, and the capital city of the Tenth Region. In the past, its population was quite transient, but many were now staying and establishing their own small businesses.

La Serena's principal industries were mining (especially iron and gold) and the cultivation and export of table grapes and wines. A drawback to this market from MC's perspective was the large distance from Temuco, over 900 miles. How could the company provide installation and after-sales service so far away?

The next market being evaluated was Region Eight, directly to the north of Temuco. It included several lake and ocean resort areas; two large cities, *Concepcion* and *Talcahuano*; and two medium-sized cities, *Los Angeles* and *Chillan*. Concepcion, Chillan, and Talcahuano were only three hours from Santiago, and Los Angeles was closer to Temuco than Santiago.

Primary industries in the Eighth Region included coal mining (accounting for 90% of the country's production), textiles, paper and cellulose processing (two plants were opened here in 1992, representing a \$1.0 billion dollar investment), and tourism. The Region was heavily dependent on agriculture. Most major purchases were bought on credit until cash crops were harvested and sold, and the majority of retailers offered this service to local residents.

Osvaldo's sister, Anjelica, had left the family and moved to San Martin de los Andes, Argentina when she married an Argentine 20 years before. She remained emotionally very close to her family in Chile, and was thrilled when her younger brother took over her father's business. Her husband travelled frequently in his job, and her teenage sons had their own interests. She had a flourishing Tupperware sales business in San Martin but thought she might be ready to transfer those sales skills elsewhere. Daniel had his doubts about this, but since Osvaldo was so enthusiastic, he deferred to his brother-in-law.

San Martin de Los Andes and Bariloche were both popular resort towns with a combined population of about 100,000 permanent residents, six hours through the Andes east of Temuco. Consequently, many wealthy Argentines were building summer homes there by the lake and condominiums by the ski mountains.

Twenty years of "parrillas" (or Argentine barbecues) had introduced Anjelica to many of the town's permanent residents, and she had formed strong friendships with several architects and their families. So, the whole family agreed, it was time for MC to enter the Argentine market. Argentina was nearly as expensive as the United States, so she felt a lower-cost Chilean product would be popular there, especially if it came with the kind of quality that notoriously fussy Argentine tastes demanded. Anjelica did some research on import taxes and other charges and found out that product selling for \$6,000 in Temuco would have to cost \$11,529.30 delivered in Argentina. The analysis, shown in Exhibit 4, applied to assembled furniture only, not separate pieces. The government of Chile helped its exporters by not charging IVA¹⁰ on any materials used in the manufacture of a product for export, or on the exported product itself—a significant cost reduction.

EXPAND SALES IN TEMUCO AND SURROUNDING TOWNS

MC had developed an excellent reputation with virtually no promotion other than participating in trade fairs in Temuco and Santiago. A strong selling point had been the rapid delivery time on all orders. MC's policy had been to deliver all items on or before the date promised, usually within 30 days (as compared to the competition in Santiago, where the minimum was generally at least 90 days).

MC's kitchen and bath furniture was currently on display in the back of CasaBlanca, a downtown home furnishings store. The store had an excellent, highly visible location and a strong reputation for high-end, high-quality products. Although MC's owners admittedly had not given the store manager a great deal of direction and communication was infrequent, they felt he was not rotating the furniture on a regular enough basis nor selling enough to warrant their continued participation. Hence, Osvaldo had not been as quick to get price quotes to this establishment as he was with factory-direct customers.

They were currently negotiating with Imysa and Rancada S.A., two large, local construction companies. Imysa built mainly office buildings, and Rancada concentrated on home sales. For a 5% commission charge on sales, Osvaldo and Daniel wanted their furniture to be

Exhibit 4 SHIPMENT COSTS TO ARGENTINA

For 1,000 kilos of weight, the cost would be between US\$600-700 for transport door-to-door between Temuco and San Martin. Assuming no orders were shipped of value less than \$6,000, this would be 10% of the cost of the order.

 Value of order Freight 10% Insurance (2% of net value of invoice) SUBTOTAL I CIF—Cost of Insurance and Freight 	\$ 6,000.00 600.00 120.00 \$ 6,720.00
ARGENTINE TAXES (on value of invoice): (Note: Argentine taxes are cumulative)	
4) Tax for international access 22% SUBTOTAL 2	\$1,320.00 7,320.00
5) IVA (Value Added Tax) 18% SUBTOTAL 3	1,317.60 8,637.60
6) Withholding tax 8%SUBTOTAL 4	691.00 9,328.60
7) Commercial tax 3% SUBTOTAL 5	279.85 9,608.45
8) Statistics tax 10% SUBTOTAL 6	960.85 10,569.30
9) Freight forward/import fee (4% of invoice) SUBTOTAL 7	240.00 10,809.30
Original freight and	

included in each model home/office currently under construction by these companies.

insurance charges

GRAND TOTAL

Another option was adding a sales outlet in the new Temuco Mall on the outskirts of town. The mall had many upscale shops, boutiques, and several mainstream furniture stores. They believed their line of goods would sell well there.

Osvaldo and Daniel were not satisfied with the sales performance of Arturo, Jr., and felt that local sales could have grown much faster with all the growth opportunities in the area. They wanted to give the territory to someone who was eager to earn *plata*, or cash. Since Arturo, Jr. was family, however, they were unwilling to confront him with this proposal.

720.00

\$11,529,30

Option 2. Market Penetration: Start a New Line of "Stock" Furniture

The company was also considering expanding production by starting a new line of stock kitchen cabinets. These were to be made of melamine, and in nine basic models. Some flexibility was to be included, as countertops could be chosen in one of three colors (white, cream, or natural wood); melamine doors could be chosen in white, cream, light grey, or granite; and door and drawer handles were to be available in six different colors. Neither installation nor transportation nor after-sales service was to be included, but the price would be much more mid-range. Home Town, a new U.S.-style housewares/building supplies establishment in Chile, had expressed an interest in selling such a product if made available at the right price. Home Town had stores in Temuco, in Region Eight in Concepcion and Los Angeles, and in Santiago, with more planned country wide. Though Home Town was the owners' first choice, several other national department store chains such as Rileys and Mirabella carried local products and they were being evaluated as backups. The owners did not know if Home Town would insist on exclusive distribution rights.

Analysis of Demand

Statistical and demographic information used in the United States, such as average income in various geographic segments, was not available in Chile. Neither total domestic sales in the furniture industry, nor market share was recorded. Demand analysis was done based on secondary information provided by the National Institute of Statistics and local municipalities.

EXTENT OF DEMAND

The Temuco region was currently experiencing an explosive growth rate, and the anticipated multiplier effect was seen in the local industries. Included were populations and rate of growth for several target markets (see Exhibit 5).

According to the National Institute of Statistics, private home construction increased on a national level by 18.4% in the first four months of 1993, as opposed to 1992. Office building construction increased by 23.9% in the same period (see Exhibits 6 and 7).

Exhibit 5 CHILEAN POPULATION GROWTH								
Population	1992	1982	% Variation					
Region IX TEMUCO	255,186	157,634	+63%					
Region IV LA SERENA	120,522	83,283	+ 45%					
Region VIII CONCEPCION TALCAHUANO CHILLAN LOS ANGELES	314,953 254,542 164,491 138,313	202,368 118,163						
Region X VALDIVIA OSORNO PUERTO MONTT	124,518 138,488 126,982	95,286 84,410	+ 24% + 45% + 50%					
Source: National Inst	titute of Sta	tistics						

Exhibit 6 NEW PRIV		ONSTRUCTION
Year	Number	% Variation
1007	750	22.0

1986	750	-33.0
1987	۱,797	+ 139.6
1988	1,811	+ 0.8
1989	3,330	+83.9
1990	1,416	– 57.5
1991	2,275	+60.7

Period + 193.9% Annual Average + 32.3%

Source: Municipality of Temuco

Exhibit 7 UNEMPLOYMENT RATE IN TEMUCO

Year	Rate
1985	6.9%
1986	7.0%
1987	5.7%
1988	4.1%
1989	2.7%
1990	3.0%
1991	2.8%

Source: Municipality of Temuco

NATURE OF DEMAND

Daniel and Osvaldo anticipated that demand for their furniture would be tied with regional statistics. The average cost of a custom-designed and built kitchen could range from Ch\$300,000 to \$1,000,000 pesos (approximately US\$750–2,500), a significant sum in a country where the minimum wage was Ch\$38,600 pesos per month. Much of the current made-to-order business had been generated by word of mouth. A certain level of status was associated with a Muebles Copihue kitchen. It was known to be both of high quality and expensive.

A line of stock furniture would sell to middle-class Chileans for a discount of approximately 40% off the made-to-order price but would be of the same high-quality construction. This client was much more price conscious than the made-to-order client, and would comparison shop extensively before buying. They would need further education to identify and appreciate quality construction. A strong selling point with the stock line was the ability to buy one or two pieces at a time, and add more as the budget allowed. This client also depended heavily on credit and payment schedules. Although all the large retail outlets offered this service to their clients, MC did not.

Sales were typically higher in the summer months (December through March). Housing construction was accelerated to beat the onslaught of autumn and winter rains in the south, and travel to Temuco was much easier for residents of outlying areas.

Competition

Competition for made-to-order kitchens in the area was minimal, but for stock kitchens, it was significant. Two large furniture factories in Valdivia, two hours south of Temuco, provided most of the competition. Flor del Sur did mostly made-to-order kitchens—of good but not excellent quality, and they were less expensive. Cocinas Chile manufactured stock kitchen furniture, selling in various retail outlets throughout the south, and minimal made-to-order business. There were several small factories in the Temuco area, but these factories generally employed five people or less, and certainly could not supply product in any great volume.

Mirabella carried three lines of stock furniture, all manufactured in Santiago. The same brand was carried in at least five other stores in Temuco alone. Mirabella had outlets in all the major cities of Chile, and it was currently the largest department store chain in the country. Clients were typically middle to upper-middle class.

Home Town currently carried five different lines of stock furniture, manufactured in Santiago, and a line by Cocinas Chile based in Valdivia. They were looking to expand to seven lines, but floor space was quite limited. Cocinas Chile employed its own salesperson at Home Town to represent their lines personally. The two least expensive lines were also the most popular. Their appearance and construction were of far lesser quality than MC's line, and prices were about 5–10% lower. Clients were typically middle class and up, but many people came just to see what products were new in Home Town. Stock was rotated frequently, and the home improvement center concept was new enough in Chile to attract curiosity.

Puerto Montt and La Serena had only three outlets to buy stock furniture. Temuco had no less than seven. Concepcion and its sister city, Talcahuano, were saturated with sources. Chillan had very few but was only one hour from Concepcion.

Projected Sales

Muebles Copihue's sales for 1992 showed considerable variation from month to month (see Exhibit 8). The plan they sought had to help them look beyond this monthly volatility to develop a longer-term perspective. They asked the financial consultant to take a 10-year perspective, drafting anticipated incremental annual cash flows for the business, shown in Exhibit 9.

The following expectations were built into this projected cash flow analysis:

- I. Made-to-order sales will increase on average 25% next year. This is based on the number of unfilled orders currently received.
- 2. The sale of stock kitchens, after one year of operation, will reach 50% of the historical average of made-to-order kitchen sales. This arbitrary figure, the owners agreed, was reasonable based on their feel for the market.

Exhibit 8 MUEBLES CO MONTHLY SA in US Dollars	•	۸.					
	Jan	Feb	Mar	Apr	May	June	July
Kitchens (80%)	\$23,761	\$8,968	\$15,176	\$16,311	\$26,026	\$21,282	\$29,261
Vanities (10%)	2,971	1,121	1,897	2,039	3,253	2,661	3,658
Closets (10%)	2,971		1,897	2,039	3,253	2,661	3,658
TOTAL (100%)	\$29,703	\$11,211	\$18,971	\$20,389	\$32,532	\$26,603	\$36,576
	Aug	Sept	Oct	Nov	Dec	TOTAL	AVERAGE
Kitchens (80%)	\$36,855	\$20,808	\$34,366	\$31,742	\$44,384	\$308,939	\$25,745
Vanities (10%)	4,608	2,600	4,295	3,968	5,547	38,618	3,218
Closets (10%)	4,608	2,600	4,295	3,968	5,547	38,618	3,218
TOTAL (100%)	\$46,071	\$26,008	\$42,955	\$39,679	\$55,479	\$386,176	\$32,182

- 3. The sales of stock kitchens will be 51% base furniture and 49% wall cabinets, as historically noted by the owners.
- 4. Future sales of made-to-order kitchens will increase an average of 2% annually for the next five years—a conservative estimate in accordance with the national growth rate—and no further sales growth is planned for years 6 through 10.

The Bank of the State of Chile was sufficiently impressed with the projection in Exhibit 9 to award them a small business loan at an interest rate of 9% to purchase both the land and equipment. The equipment purchase order was placed with the manufacturer in Spain, and the management team of Muebles Copihue prepared to assume a leadership position in the Chilean kitchen and bath furniture market.

Daniel and Osvaldo decided to pursue all their ideas for expanding sales. They figured a shotgun approach would be the quickest, least expensive, and easiest way to step up sales. Furthermore, they had family members in several key markets who were willing and eager to get to work for them. A large furniture fair was planned by the local cooperative for April, and they wanted to make a strong showing there, introducing their new line of stock furniture to the large number of expected visitors.

Daniel and Osvaldo felt positive about the future. Although they had incurred some substantial expenditures, they felt that their investment was worthwhile. All would pay off in increased sales and increased presence in the local and surrounding markets.

Exhibit 9											
PROJECTED II	NCREME	NTAL	ANNU	AL CAS	SH FLO	WS					
in US Dollars	YEAR										
SALES	0	ı	2	3	4	5	6	7	8	9	10
MADE TO ORDER: Kitchens Vanities Closets		\$ 41,589 5,195 5,195	\$ 84,032 10,500 10,500	\$ 91,892 11,482 11,482	\$ 99,908 12,484 12,484	\$108,084 13,505 13,505	\$108,084 13,505 13,505	\$108,084 13,505 13,505	\$108,084 13,505 13,505	\$108,084 13,505 13,505	\$0 13,505 13,505
SOLD FROM STOCK: Kitchen Base Kitchen Wall		133,587 133,032	260,739 258,926	265,953 264,105	271,279 269,392	276,716 274,792	276,716 274,792	276,716 274,792	276,716 274,792	276,716 274,792	276,716 274,792
TOTAL SALES		\$318,597	\$624,697	\$644,913	\$665,547	\$686,603	\$686,603	\$686,603	\$686,603	\$686,603	\$578,518
OPERATING COSTS:											
MADE TO ORDER: Kitchens Vanities Closets		\$ 20,795 2,597 2,597	\$ 42,016 5,250 5,250	\$ 45,947 5,742 5,742	\$ 49,955 6,242 6,242	\$ 54,042 6,753 6,753	\$ 54,042 6,753 6,753	\$ 54,042 6,753 6,753	\$ 54,042 6,753 6,753	\$ 54,042 6,753 6,753	\$ 54,042 6,753 6,753
SOLD FROM STOCK: Kitchen Base Kitchen Wall		81,166 80,829	158,421 157,321	161,589 160,466	164,826 163,679	168,129 166,961	168,129 166,961	168,129 166,961	168,129 166,961	168,129 166,961	168,129 166,961
Salaries/Direct Sales Expenses General Costs Salaries/Indirect Depreciation Interest		0 12,484 9,366 0 10,789 19,363	0 24,463 9,366 0 10,789 18,186	0 25,221 9,366 0 10,789 14,860	0 25,997 9,366 0 10,789 11,223	0 26,789 9,366 0 10,789 7,245	0 26,789 9,366 0 10,789 2,908	0 26,789 9,366 0 10,789	0 26,789 9,366 0 10,789	0 26,789 9,366 0 10,789	0 26,789 9,366 0 10,789
TOTAL COSTS		\$239,997	\$431,062	\$439,723	\$448,320	\$456,827	\$452,490	\$449,582	\$449,582	\$449,582	\$449,582
SUBTOTAL		\$ 78,601	\$193,635	\$205,190	\$217,227	\$229,776	\$234,113	\$237,021	\$237,021	\$237,021	\$128,937
+ Salvage Value Taxes (15%)		11,790	29,045	30,779	32,584	34,466	35,117	35,553	35,553	35,553	53,945 27,432
TOTAL AFTER TAXES		\$ 66,811	\$164,590	\$174,412	\$184,643	\$195,310	\$198,996	\$201,468	\$201,468	\$201,468	\$155,450
+ Depreciation		10,789	10,789	10,789	10,789	10,789	10,789	10,789	10,789	10,789	10,789
- Miscellaneous Owner I	Expenses	15,789	15,789	15,789	15,789	15,789	15,789	15,789	15,789	15,789	15,789
NET CASH FLOW	(\$215,243)	\$ 61,811	\$159,590	\$169,412	\$179,643	\$190,310	\$193,996	\$196,468	\$196,468	\$196,468	\$150,450
AMORTIZATION OF LO	DAN	\$0	\$ 35,745	\$ 39,074	\$ 42,710	\$ 46,684	\$ 51,032				
EVALUATIO	<u> </u>				<u>II</u>	NVESTMENT	<u>Г:</u>				
PROFITABIL	NT VALUE (Inte ITY INDEX RATE OF RETU		6) \$875	i,542 I.484 60.29%	LAND MACHINERY & EQUIPMENT WORKING CAPITAL			\$ 26,3 161,8 	323		
					Т	OTAL INVE	STMENT		\$215,2	243	

CASE B

May 1993: Four Months Later Management Meeting at Muebles Copinue

The new machinery would be arriving next week, and re-enforcement of the plant floor to support the added weight had been completed. The purchase of the adjoining land had gone through, although at the last minute the neighbor decided that US\$32,895 was a "fairer" price than the original \$26,315. Expansion of the warehouse and paint rooms was underway as planned. The Temuco Furniture Fair had been a big success, and MC's three stands full of beautiful kitchen and bathroom furniture created quite an impression on many of the 40,000 attendees; several new contacts were made by the owners. However, the sales figures were equal to the historical average, with few pending additional orders. The brothers-in-law felt they needed to review what was happening with their sales team. So, along with Mauricio, they reviewed each market individually.

Temuco: Most of their business was still coming from here. Sales were steady with private client orders and a few new commercial orders. As of last month, Arturo, Jr. had decided to start his own furniture company with his wife's brother. (Although it was for "middle-class clients," and although he was using many of his MC sales contacts to get his business started, he assured Osvaldo and Daniel that he would not be competing with them directly).

The owners had tried to juggle sales and design along with their other duties, and realized they could not continue this indefinitely. In the last few weeks, several customers had complained about the finish and installation of their kitchens. Distracted by all the latest developments, price quotes were delivered later than promised, and several furniture delivery dates were missed through mixups. They needed to find a new sales representative for Temuco, one with many local connections and knowledge of the local market.

Fortunately, the head sales representative from one of their competitors approached them with the possibility of switching firms. Daniel and Osvaldo spent several evenings with this candidate, sharing friendly stories and a few beers. A deal was agreed upon, it seemed, until it came time to sign the contract. Then, using the more formal usted form of Spanish, he presented them with the news that "the company really wanted him to stay, and since they were like family," he needed more time to evaluate the change. After one week, when no word came, and Osvaldo's phone calls to the candidate were not returned, it became apparent the offer had been refused. The three could not think of any other friends or contacts who would fit the bill.

In addition, although Home Town of Santiago had approved carrying their goods in the local store, they were now waiting to be assigned a sales code in Home Town's computer system. Without this code, no sales could take place. No firm date had been given for this assignment; "we will let you know," was the typical response to their frequent inquiries to Santiago. Daniel had a made a trip to Home Town to buy a new telephone and was somewhat disturbed to realize how little the employees knew about their products. Any queries about comparison of quality were met with the response: "I really don't know, you'll have to ask the manager." How could his furniture, more expensive but of better quality than the competition, sell well when the salespeople were not properly informed, and did not have the initiative to arm themselves with product information? Mirabella department store had a reputation for being more service oriented, but did he risk losing Home Town's greater potential volume nationwide if he tried to establish a relationship with Mirabella as well?

The flyers for the new line of stock furniture looked good, and over 3,000 had been distributed at the Furniture Fair. In the following two weeks, three orders had been received and filled. A local TV cable cooking show was utilizing one of their nicest model kitchens—worth Ch\$1,000,000 pesos—on its daily programs, but as of yet no client had mentioned seeing them on television. Of course, the number of residents with access to cable TV was still only 6,000 out of Temuco's 250,000 residents.

Neither Imysa or Rancada had given MC an answer concerning the pilot home offer. In reality, local con-

struction had slowed down significantly, since winter was approaching, and many new homes would not be ready for kitchens and closets until the warmer weather of November or December.

The Temuco Mall, while upscale and luxurious, was having its own difficulties luring residents out of downtown to buy. Their management tempted shoppers with free jazz concerts and bingo on weekends to increase foot traffic. The number of visitors jumped to 20,000 on a typical weekend, but no information was available on increased sales per square foot.

Puerto Montt: In January, Daniel's cousin in Puerto Montt began making contacts with local architects and construction companies, as well as by word of mouth. He was a teacher, and since school did not start again until March, he wanted to use this time to get MC's name known about town. He came to the plant for two days to become acquainted with the product. By May, he had made two sales, but found himself with much less time than anticipated to make sales contacts with school in session. No further investment in marketing or promotions was done.

A local distributor of kitchen and bath furniture had been impressed with MC's showing at the Temuco Fair and wanted to represent their new stock line, as well as some new lacquered vanities MC introduced. Daniel and Osvaldo wanted to cut the wholesale price to 5% over the price offered by Home Town but realized they would have to analyze transport options more closely. With the rainy season beginning, they would have to formulate some way to protect the furniture from the elements. The purchase of a large, enclosed truck would be an inordinate expense, but the first batch of newly lacquered vanities arrived in Puerto Montt with streaked paint after being battered by the monsoon rain and winds.

Chillan: No sales yet from this area. The sister-inlaw visited the Temuco Furniture Fair and went back enthused about MC's contribution. However, she was receiving some pressure at home from her husband, who was not sure he liked his wife working. He also missed her home-baked bread and conversation at 6:00 pm every evening. La Serena: The models sent up to the architect friend arrived broken and scratched after being tossed around by the freight company. Freight had turned out to be enormously expensive for fully assembled pieces. Although the representative had agreed to pay for transport costs, his resulting increase in prices could lower potential sales. There were no sales yet.

Argentina: Osvaldo was surprised to see Anjelica come through the factory door one day last week. She greeted him warmly: "I came down to talk with you about the furniture situation there. I have made so many contacts, and yet I can't get a firm answer from the architects as to 'yes' or 'no', just 'we'll get back to you.' They are always impressed with the price and quality, but when I mention the factory is in Chile, the enthusiasm seems to diminish."

Mauricio overheard the conversation, and added "You know, I spoke with a representative from Argentina at the fair. He told me that while he thought our furniture was attractive and well made, most Argentines won't accept a kitchen countertop made of postform and formica. They can't be convinced that it is as resistant to heat and water as are granite or marble. Hence, most well-to-do clients, although it's much more expensive, will choose granite or marble countertops every time."

Anjelica responded, "Well, the whole thing makes me tired. I'm going to spend the week here visiting with Mom and my sisters. The trip was particularly long this time because I had to detour down to the Osorno pass—our usual pass through the mountains is already blocked in with snow. Maybe we should think of a new slogan for the furniture, or an advertising campaign."

The next night, Daniel and Osvaldo went out to dinner to talk over what they had reviewed. Between bites of grilled sirloin and sips of Pisco Sours (Chile's "national cocktail" made of Pisco—a distilled grape brandy—with lemon juice and sugar), they mused about their current plight. Had they expanded markets too quickly without thorough evaluation? What steps should they take to promote their products, support their sales representatives and generate sales? How was their personal management style helping or hurting Muebles Copihue's long-term prospects?

Notes

¹This case was written by M. Kim Heath of California Polytechnic State University, San Luis Obispo. It is intended as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

² A colectivo is a private car which operates everywhere as public transportation in Chile. It runs a set route as does a bus, is slightly more expensive than a bus, and infinitely more comfortable. The exchange rate between Chilean pesos and U.S. dollars was 380:1, so Ch\$1,000 equaled around US\$2.63.

³Once (pronounced "own-say") is the light meal served between 5 and 7 pm—generally coffee and a sandwich. It is designed to appease one's appetite until dinner is served around 10 pm. Once is Spanish for "eleven." Legend has it the name came from the eleven letters in the powerful alcoholic beverage called aguardiente. Chilean men used the euphemism "going to have their "once" to keep their wives from knowing aguardiente was what they were really drinking. It is questionable as to whether any of the wives were actually fooled.

⁴The Mapuche are one of the few surviving indigenous peoples in Chile, and the majority of their population remains located around Temuco. Although economically depressed in relation to the Europeanized population, they hold fast to their language, way of dress and agricultural background. They are fiercely independent and did not formally submit to Chilean governmental authority until the 1930s. Many still utilize wooden horse drawn carts as their primary means of transportation from their farms to the city markets. It is not uncommon to see horses and carts parked next to Nissans and Fords in downtown Temuco, clicking off time on parking meters.

⁵Muebles (pronounced "moo-eb-lays") is Spanish for "furniture." The *Copihue* ("co-pea-way") is the much admired national flower of Chile, and is found growing abundantly in bright red clusters in the South. S.A. signifies *Sociedad Anonima*, or the equivalent of "incorporated."

⁶Base furniture includes lower cabinets with countertops and baseboards. Wall models are cabinets attached to kitchen walls.

⁷Chile is divided into 13 separate areas or "Regions" beginning in the north and running south—2,700 miles. Chilean territory also includes part of Antarctica, Easter Island (an island of Polynesian descent 2,000 miles away in the South Pacific) and the Juan Fernandez or Robinson Crusoe island chain, 400 miles off the coast. A cantankerous Scottish sailor named Alexander Selkirk was deposited here by the captain of his ship in the 18th century, and upon his rescue four years later, his increasingly grandiose tales of survival in the wild inspired Daniel Defoe to write his classic novel.

⁸All accounts were done by hand. Records were kept in notebooks, and receipts and paperwork were filed in large folders. Most bills were paid using postdated checks issued at the time of purchase. This was common practice in Chile, as it eliminated many billing costs and acted as a deposit for the sale. It was a fairly effective system, as the banking sector was meticulous in their attention to check dates, and penalties for overdrawn accounts included a prison sentence.

⁹Chile, while less *machista* or male dominated than other Latin countries, still places high emphasis on families and the mother as the tie that binds. Five of the seven women in the factory were single mothers. As abortion is illegal, and birth control frowned on by the Catholic Church, one in three Chilean babies are illegitimate. Chileans tend to marry very young. Although divorce is illegal, marriages with some difficulty and expense can be "annulled." Many Chileans feel the official view of marriage and family in their country is institutionalized hypocrisy that has to change.

¹⁰IVA (*Impuesto al Valor Agregado*) or Value Added Tax was a tax applied to sales and transactions of tangible personal property, as well as to certain services. In Chile in 1993, IVA was 18%. It was scheduled to be reduced to 16% in 1994, but the deficit in Chile's current social welfare programs budget made that unlikely.