
Surya Silks (Pvt.) Ltd.¹

KATHMANDU, NEPAL

Overview

Surya Silks (Pvt.) Ltd. is a newly formed silk producer founded by an American expatriate who has lived in Nepal for 22 years. With an expanding farm of mulberry bushes to feed its silkworms and adequate means to dry its silkworm cocoons, the firm now wants to forward integrate into silk reeling operations, the next phase in the production process. Many bureaucratic and financial obstacles block Surya's purchase of a government-owned silk reeling unit, however. Selling the unit to the private sector might jeopardize development funding from the South Korean government. Also, current cocoon and reeled silk fiber price levels make Surya's purchase questionable at best. Although a significant under-table payment could smooth the original purchase, the company must consider the overall profitability of the venture. A decision must be made whether to purchase the unit from the government, from an overseas distributor, or not to enter silk reeling at all.

Teaching Purpose and Objectives

The case can be used either at the graduate or undergraduate level within Strategic Planning and Government/Business Policy courses as well as in International or Comparative Management classes. The case is intended for class discussion regarding project planning rather than as a basis for ethics conversations. Because it involves making a strategic decision based upon very basic accounting and management analysis techniques, it could be used early on in the class term.

Case Study Issues

KEY ISSUES

The main class discussion about this case should encompass:

- Making a mutually exclusive investment decision based on limited knowledge.
- Dealing with and overcoming ambiguous information.

SECONDARY CASE ISSUES

In addition to the key issues, class time may be spent discussing any or all of the following issues:

- Ethics issues and frameworks for general business dealings in Nepal, including the appropriateness of gifts and bribery.
- Business-government relations and dynamics of enterprise privatization, along with the problems that occur when public and private sector goals conflict.
- Raw material supply concerns for Surya's reeling unit that might follow privatization and a switch to market prices.
- Some general socioeconomic issues specific to Nepal; such as average salaries, cost of living, and political stability.

This case introduces students to the complex conditions surrounding business ventures in the developing world. Although the decision called for would be quite simple to make in a United States context, it becomes

quite cumbersome in a country like Nepal. This case specifically illustrates misinformation that occurs when government workers' agendas do not match those of the private sector. Among each potential outcome, there are several variables that change the attractiveness of purchasing or leasing the unit.

Teaching Plan

In order to derive maximum learning benefit from the Surya Silks case, the author recommends the instructor follow a teaching plan similar to the one outlined below.

INTRODUCTION OF THE CASE

The instructor should take significant class time to describe the objectives and guidelines for analyzing this case. In the best situation, the case calls for their management decision based on available information and educated hypotheses. This case is well suited to using software-based pro forma statements because of the wide variety of options available. The instructor may choose to recommend that students use computer spreadsheets. Three particular assignments the instructor might wish to make are:

- Generate several investment plan options, one for each value of the inputted variables (the instructor might wish to specify the number of options to analyze),
- Review exhibits and footnotes in depth for critical case information and key points of interest, and
- Acknowledge that there is conflicting information within the case and that students should address those conflicts directly in their analysis.

CLASS SESSION OVERVIEW AND CASE ANALYSIS

Class analysis and discussion about Surya's decision should occur within a format that could best be described as a "peeling the onion" approach. In other words, the initial perception that Surya's decision is quite elementary should give way to more complex issues as layers of information are peeled away during class conversation. The instructor should capitalize on the ambiguity of information by continuously asking students for their sources of information on key points.

Cash flow worksheets outlining the feasibility of acquiring the government and Indian-built reeling units are

provided in Teaching Note Exhibits 1 through 4. The reeling unit's profitability is almost exclusively dependent on raw material costs and reeled silk prices. For this reason, the purchase of any reeling unit is quite risky, given the inherent volatility of both products' pricing. Most of the other cost sources, with the possible exception of land and buildings, tend to contribute little to the decision.

Each exhibit is a two-part presentation of the options. Only four options are presented because they represent the most feasible outcomes. For each Teaching Note Exhibit, the bottom part is a data entry sheet that outlines the variables inputted to generate each cash flow statement.

All pro forma cash flow statements make the following assumptions:

- No discounted cash flows other than those for Nepal's high inflation rate of 20%;
- Learning curve-based increases in productivity—the reeling unit operates at minimum efficiency during The first year, then improves to reach optimal efficiency by the third operating year;
- A 250-day work year;
- 13-month payment year for Mainali and Ghale, based on footnote 10;
- A five-year equipment depreciation scheme for the equipment (any scheme may be used); and
- All other cash flows as outlined in Exhibit 8.

FEASIBILITY OF KHOPASI'S REELING UNIT

Scenario 1—Purchasing the Government Unit and Using Government Pricing Levels

Teaching Note Exhibit 1 calculates cash flows for the case in which Surya Silks acquires the government reeling unit and all of the government's current pricing levels. It makes the assumptions that Surya purchases the unit for not only the Indian equipment cost, but also the NRs. 100,000 payment to Mr. Kafle. It is Surya's worst case scenario and, obviously, an unattractive proposal. At this point, the instructor or one of the students might raise the subject of payoffs to government officials (see Issue 1 section).

Teaching Note Exhibit I

PROFORMA CASH FLOW STATEMENT FOR KHOPASI REELING UNIT AT GOVERNMENT PRICING LEVELS

(all numbers in Nepali Rupees [NRs.]

	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5
PERIOD BEGINNING BALANCE	0.00	-7400913.00	-8884463.00	-10507693.00	-12130923.00
Cash From Sales	15379200.00	19224000.00	23068800.00	23068800.00	23068800.00
TOTAL CASH INFLOW	15379200.00	19224000.00	23068800.00	23068800.00	23068800.00
CAPITAL INVESTMENT					
Land	135000.00	0.00	0.00	0.00	0.00
Building	4962743.00	0.00	0.00	0.00	0.00
Reeling/Twisting Unit	100000.00	0.00	0.00	0.00	0.00
Generator	400000.00	0.00	0.00	0.00	0.00
Boiler	155000.00	0.00	0.00	0.00	0.00
Total Equipment	655000.00	0.00	0.00	0.00	0.00
TOTAL CAPITAL INVESTMENT	5752743.00	0.00	0.00	0.00	0.00
VARIABLE COSTS					
Raw Material	14400000.00	18000000.00	21600000.00	21600000.00	21600000.00
Direct Labor	106000.00	106000.00	106000.00	106000.00	106000.00
Fuel for Boiler	210000.00	210000.00	210000.00	210000.00	210000.00
Fuel for Generator	35700.00	35700.00	35700.00	35700.00	35700.00
Total Utilities	245700.00	245700.00	245700.00	245700.00	245700.00
Maintenance (@25% Equipment Cost)	163750.00	163750.00	163750.00	163750.00	163750.00
TOTAL VARIABLE COSTS	14915450.00	18761150.00	22361150.00	22361150.00	22361150.00
SET UP COSTS (One-time)					
Moving Charges	300000.00	0.00	0.00	0.00	0.00
Piping, electrical, and hardware	250000.00	0.00	0.00	0.00	0.00
TOTAL SET UP COSTS	550000.00	0.00	0.00	0.00	0.00
OVERHEAD					
Sales & Expenses	24000.00	24000.00	24000.00	24000.00	24000.00
Administration (10% of Gross Sales)	1537920.00	1922400.00	2306880.00	2306880.00	2306880.00
TOTAL OVERHEAD	1561920.00	1946400.00	2330880.00	2330880.00	2330880.00
TOTAL CASH OUTFLOW	22780113.00	20707550.00	24692030.00	24692030.00	24692030.00
CASH FLOW FOR YEAR	-7400913.00	-1483550.00	-1623230.00	-1623230.00	-1623230.00
NET CASH FLOW	-7400913.00	-8884463.00	-10507693.00	-12130923.00	-13754153.00

Production Rate (kg of cocoon/shift) =
Annual Production (kg raw silk) = 9600 12000 14400 14400 14400

REVENUES : = REELED SILK SELLING PRICE (NRs./kg)

ASSET VALUES : = COST OF LAND (NRs.)

= COST OF BUILDING (NRs.)

= REELING/TWISTING UNIT PURCHASE PRICE (NRs.)

= GENERATOR PURCHASE PRICE (NRs.)

= BOILER PURCHASE PRICE (NRs.)

= TOTAL EQUIPMENT COST (NRs.)

RAW MATERIAL COST : = FRESH COCOON PURCHASE PRICE (NRs.)

VARIABLE COSTS : = DIRECT LABOR COST (NRs.)

= FUEL FOR BOILER (NRs.)

= FUEL FOR GENERATOR (NRs.)

Teaching Note Exhibit 2

PROFORMA CASH FLOW STATEMENT FOR INDIAN REELING UNIT AT MARKET PRICING LEVELS

(all numbers in Nepali Rupees [NRs.])

	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5
PERIOD BEGINNING BALANCE	0.00	-5533210.65	-4525754.90	-3153820.75	-1781886.60
Cash From Sales	11872704.00	14840880.00	17809056.00	17809056.00	17809056.00
TOTAL CASH INFLOW	11872704.00	14840880.00	17809056.00	17809056.00	17809056.00
CAPITAL INVESTMENT					
Land	135000.00	0.00	0.00	0.00	0.00
Building	4962743.00	0.00	0.00	0.00	0.00
Reeling/Twisting Unit	219145.00	0.00	0.00	0.00	0.00
Generator	400000.00	0.00	0.00	0.00	0.00
Boiler	155000.00	0.00	0.00	0.00	0.00
Total Equipment	774145.00	0.00	0.00	0.00	0.00
TOTAL CAPITAL INVESTMENT	5871888.00	0.00	0.00	0.00	0.00
VARIABLE COSTS					
Raw Material	9227520.00	11534400.00	13841280.00	13841280.00	13841280.00
Direct Labor	106000.00	106000.00	106000.00	106000.00	106000.00
Fuel for Boiler	210000.00	210000.00	210000.00	210000.00	210000.00
Fuel for Generator	357000.00	357000.00	357000.00	357000.00	357000.00
Total Utilities	245700.00	245700.00	245700.00	245700.00	245700.00
Maintenance (@25% Equipment Cost)	193536.25	193536.25	193536.25	193536.25	193536.25
TOTAL VARIABLE COSTS	9772756.25	12325336.25	14632216.25	14632216.25	14632216.25
SET UP COSTS (One-time)					
Moving Charges	300000.00	0.00	0.00	0.00	0.00
Piping, electrical, and hardware	250000.00	0.00	0.00	0.00	0.00
TOTAL SET UP COSTS	550000.00	0.00	0.00	0.00	0.00
OVERHEAD					
Sales & Expenses	24000.00	24000.00	24000.00	24000.00	24000.00
Administration (10% of Gross Sales)	1187270.40	1484088.00	1780905.60	1780905.60	1780905.60
TOTAL OVERHEAD	1211270.40	1508088.00	1804905.60	1804905.60	1804905.60
TOTAL CASH OUTFLOW	17405914.65	13833424.25	16437121.85	16437121.85	16437121.85
CASH FLOW FOR YEAR	-5533210.65	1007455.75	1371934.15	1371934.15	1371934.15
NET CASH FLOW	-5533210.65	-4525754.90	-3153820.75	-1781886.60	-409952.45

Production Rate (kg of cocoon/shift) =	38.4	48	57.6	57.6	57.6
Annual Production (kg raw silk) =	9600	12000	14400	14400	14400

REVENUES : 1236.74 = REELED SILK SELLING PRICE (NRs./kg)

ASSET VALUES : 135000.00 = COST OF LAND (NRs.)

4962743.00 = COST OF BUILDING (NRs.)

219145.00 = REELING/TWISTING UNIT PURCHASE PRICE (NRs.)

400000.00 = GENERATOR PURCHASE PRICE (NRs.)

155000.00 = BOILER PURCHASE PRICE (NRs.)

774145.00 = TOTAL EQUIPMENT COST (NRs.)

RAW MATERIAL COST : 96.12 = FRESH COCOON PURCHASE PRICE (NRs.)

VARIABLE COSTS : 106000.00 = DIRECT LABOR COST (NRs.)

210000.00 = FUEL FOR BOILER (NRs.)

357000.00 = FUEL FOR GENERATOR (NRs.)

Teaching Note Exhibit 3

PROFORMA CASH FLOW STATEMENT FOR KHOPASI REELING UNIT AT MARKET PRICING LEVELS

(all numbers in Nepali Rupees [NRs.])

	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5
PERIOD BEGINNING BALANCE	0.00	-5533210.65	-4525754.90	-3153820.75	-1781886.60
Cash From Sales	11872704.00	14840880.00	17809056.00	17809056.00	17809056.00
TOTAL CASH INFLOW	11872704.00	14840880.00	17809056.00	17809056.00	17809056.00
CAPITAL INVESTMENT					
Land	135000.00	0.00	0.00	0.00	0.00
Building	4962743.00	0.00	0.00	0.00	0.00
Reeling/Twisting Unit	219145.00	0.00	0.00	0.00	0.00
Generator	400000.00	0.00	0.00	0.00	0.00
Boiler	155000.00	0.00	0.00	0.00	0.00
Total Equipment	774145.00	0.00	0.00	0.00	0.00
TOTAL CAPITAL INVESTMENT	5871888.00	0.00	0.00	0.00	0.00
VARIABLE COSTS					
Raw Material	9227520.00	11534400.00	13841280.00	13841280.00	13841280.00
Direct Labor	106000.00	106000.00	106000.00	106000.00	106000.00
Fuel for Boiler	210000.00	210000.00	210000.00	210000.00	210000.00
Fuel for Generator	35700.00	35700.00	35700.00	35700.00	35700.00
Total Utilities	245700.00	245700.00	245700.00	245700.00	245700.00
Maintenance (@25% Equipment Cost)	193536.25	193536.25	193536.25	193536.25	193536.25
TOTAL VARIABLE COSTS	9772756.25	12325336.25	14632216.25	14632216.25	14632216.25
SET UP COSTS (One-time)					
Moving Charges	300000.00	0.00	0.00	0.00	0.00
Piping, electrical, and hardware	250000.00	0.00	0.00	0.00	0.00
TOTAL SET UP COSTS	550000.00	0.00	0.00	0.00	0.00
OVERHEAD					
Sales & Expenses	24000.00	24000.00	24000.00	24000.00	24000.00
Administration (10% of Gross Sales)	1187270.40	1484088.00	1780905.60	1780905.60	1780905.60
TOTAL OVERHEAD	1211270.40	1508088.00	1804905.60	1804905.60	1804905.60
TOTAL CASH OUTFLOW	17405914.65	13833424.25	16437121.85	16437121.85	16437121.85
CASH FLOW FOR YEAR	-5533210.65	1007455.75	1371934.15	1371934.15	1371934.15
NET CASH FLOW	-5533210.65	-4525754.90	-3153820.75	-1781886.60	-409952.45

Production Rate (kg of cocoon/shift) =	38.4	48	57.6	57.6	57.6
Annual Production (kg raw silk) =	9600	12000	14400	14400	14400

REVENUES : 1236.74 = REELED SILK SELLING PRICE (NRs./kg)

ASSET VALUES : 135000.00 = COST OF LAND (NRs.)

4962743.00 = COST OF BUILDING (NRs.)

219145.00 = REELING/TWISTING UNIT PURCHASE PRICE (NRs.)

400000.00 = GENERATOR PURCHASE PRICE (NRs.)

155000.00 = BOILER PURCHASE PRICE (NRs.)

774145.00 = TOTAL EQUIPMENT COST (NRs.)

RAW MATERIAL COST : 96.12 = FRESH COCOON PURCHASE PRICE (NRs.)

VARIABLE COSTS : 106000.00 = DIRECT LABOR COST (NRs.)

210000.00 = FUEL FOR BOILER (NRs.)

35700.00 = FUEL FOR GENERATOR (NRs.)

Teaching Note Exhibit 4

BREAK-EVEN ANALYSIS FOR REELING UNIT AT MARKET PRICING LEVELS

(all numbers in Nepali Rupees [NRs.]

	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5
PERIOD BEGINNING BALANCE	0.00	-3521050.65	1605.10	4391779.25	8781953.40
Cash From Sales	11872704.00	14840880.00	17809056.00	17809056.00	17809056.00
TOTAL CASH INFLOW	11872704.00	14840880.00	17809056.00	17809056.00	17809056.00
CAPITAL INVESTMENT					
Land	135000.00	0.00	0.00	0.00	0.00
Building	4962743.00	0.00	0.00	0.00	0.00
Reeling/Twisting Unit	219145.00	0.00	0.00	0.00	0.00
Generator	400000.00	0.00	0.00	0.00	0.00
Boiler	155000.00	0.00	0.00	0.00	0.00
Total Equipment	774145.00	0.00	0.00	0.00	0.00
TOTAL CAPITAL INVESTMENT	5871888.00	0.00	0.00	0.00	0.00
VARIABLE COSTS					
Raw Material	7215360.00	9019200.00	10823040.00	10823040.00	10823040.00
Direct Labor	106000.00	106000.00	106000.00	106000.00	106000.00
Fuel for Boiler	210000.00	210000.00	210000.00	210000.00	210000.00
Fuel for Generator	35700.00	35700.00	35700.00	35700.00	35700.00
Total Utilities	245700.00	245700.00	245700.00	245700.00	245700.00
Maintenance (@25% Equipment Cost)	193536.25	193536.25	193536.25	193536.25	193536.25
TOTAL VARIABLE COSTS	7760596.25	9810136.25	11613976.25	11613976.25	11613976.25
SET UP COSTS (One-time)					
Moving Charges	300000.00	0.00	0.00	0.00	0.00
Piping, electrical, and hardware	250000.00	0.00	0.00	0.00	0.00
TOTAL SET UP COSTS	550000.00	0.00	0.00	0.00	0.00
OVERHEAD					
Sales & Expenses	24000.00	24000.00	24000.00	24000.00	24000.00
Administration (10% of Gross Sales)	1187270.40	1484088.00	1780905.60	1780905.60	1780905.60
TOTAL OVERHEAD	1211270.40	1508088.00	1804905.60	1804905.60	1804905.60
TOTAL CASH OUTFLOW	15393754.65	11318224.25	13418881.85	13418881.85	13418881.85
CASH FLOW FOR YEAR	-3521050.65	3522655.75	4390174.15	4390174.15	4390174.15
NET CASH FLOW	-3521050.65	1605.10	4391779.25	8781953.40	13172127.55

Production Rate (kg of raw silk/shift) =
Annual Production (kg raw silk) = 9600 12000 14400 14400 14400

REVENUES : = REELED SILK SELLING PRICE (NRs./kg)

ASSET VALUES : = COST OF LAND (NRs.)

= COST OF BUILDING (NRs.)

= REELING/TWISTING UNIT PURCHASE PRICE (NRs.)

= GENERATOR PURCHASE PRICE (NRs.)

= BOILER PURCHASE PRICE (NRs.)

= TOTAL EQUIPMENT COST (NRs.)

RAW MATERIAL COST : = FRESH COCOON PURCHASE PRICE (NRs.)

VARIABLE COSTS : = DIRECT LABOR COST (NRs.)

= FUEL FOR BOILER (NRs.)

= FUEL FOR GENERATOR (NRs.)

Issue 1**PAYOFFS TO GOVERNMENT OFFICIALS**

Although this issue is addressed at length toward the end of the case and will provide an interesting subject for class discussion, the professor should be sure that the class does not get lost in an ethics discussion that, in truth, should be relatively lucid.

According to the Foreign Corrupt Practices Act of 1977, American citizens are not allowed to use "inappropriate" gifts or compensation to obtain favorable outcomes in business dealings. This type of legislation is extremely rare in the world community and is unique in the sphere of Asian business and public dealings. Students should realize that Maggie is not technically subject to this law because she is no longer a U.S. resident citizen. For this reason, she is only restricted by her own ethics, which, in actuality, are very high. Maggie has no intention of offering Mr. Kafle any money whatsoever.

It should not be assumed, however, that Nepalis and other peoples within the region are inherently corrupt in their practices. In fact, very little corruption happens at upper levels within the Nepali system, especially within low-dollar transactions such as with the reeling unit. Students might note, by performing some quick currency conversions, that Mr. Kafle's potential gift totals \$2,000. For the most part, bribery occurs at low levels and involves small amounts of money in exchange for small favors. For this type of transaction, there is no direct U.S. legislation that prohibits "friendly exchanges."

Maggie's avoidance of this problem can be achieved quite simply. During the meeting with the Minister of Agriculture, she should obtain a commitment that no additional payments would be required of Surya other than the negotiated price of the unit. This agreement should be made without Mr. Kale's knowledge, so that his influence with the Minister would not be exercised. By making this agreement, Maggie would be able to neutralize Mr. Kafle's request for money by closing the issue with his superiors.

There are several related scenarios that students could calculate from this primary option. Although they are variations on a basic theme and change the actual cash flows slightly, none of them constitute an attractive investment option because of the poor cocoon cost/silk price ratio. Other options include:

1. Acquiring the reeling unit for no charge whatsoever,
2. Acquiring the reeling unit for only the NRs. 100,000 payment to Mr. Kafle,
3. Acquiring the Indian reeling unit for list price and using government pricing levels, and
4. Leasing either reeling unit for any reasonable rate.

Scenario 2—Purchasing the Indian-made Unit and Using Set Market Pricing Levels

Teaching Note Exhibit 2 calculates cash flows for Surya, given it acquires the Indian unit and sets its cocoon cost and reeled silk price according to the current levels given in *The Hindu's* article in Exhibit 5. This scenario assumes that the unit is purchased for the quoted price in Exhibit 7. Cocoon purchase price and silk fiber selling prices are calculated based on the average values as follows:

$$\text{Cocoon Price} = 60 \text{ Indian Rupees/kg} \times 1.602 \\ \text{conversion factor} = \text{NRs. } 96.12$$

$$\text{Reeled Silk Price} = (754 + 790)/2 \text{ Indian Rupees} \\ \times 1.602 = \text{NRs. } 1,236.74$$

This scenario shows that the silk reeling unit would be very profitable for Surya because the raw material cost and selling price are both subjected to true market forces. There are two issues that arise as an effect of this scenario.

The first, and most important, is whether or not Nepal's silk farmers will retaliate in response to the significant drop in their revenues when Surya adheres to market pricing. This subject is best addressed in the Issue 2 box.

Issue 2**DYNAMICS OF PRIVATIZATION**

Surya realized early on in its negotiations with HMG that it would be forced to acquire a great deal of inefficiency and unwanted precedents if it took on the government's reeling unit. One of the most unattractive parts of acquiring the Khopasi reeling unit is the amount of unwanted baggage that comes along with it.

The first unwanted precedent is the current pricing levels maintained by Khopasi. This is a truly double-edged sword for Surya because, on one hand, they would not be able to maintain acceptable margins if Khopasi's purchasing and selling prices are directly adopted. On the other hand, Surya faces potential loss of their raw material input if they do not buy cocoons from farmers at existing levels. Surya faces either being too high priced or losing raw material supply.

The second privatization dynamic that could harm Surya's investment is the perception that they, as a private sector company, would not be as stable as the government as a customer. If Surya were to become the primary buyer of cocoons, farmers might fear that their sericulture livelihood is no longer secure and move into other farming lines.

The second issue is the fate of Khopasi's unit if Surya does not decide to acquire it from HMG. This subject is dealt with in detail in the Issue 3 box.

Another related option that students might examine involves using market pricing and leasing the equipment from the Indian company for almost any reasonable rate.

Scenario 3—Purchasing Khopasi's Reeling Unit at Indian Unit Price and Using Market Pricing

Although the outcome is not at all different from Scenario 2, this one is presented because it has the potential to neutralize the second question given above. If Surya purchases the government reeling unit, they will emerge as the only primary purchaser of cocoons in the country, thus eliminating any future leverage that Khopasi would have to maintain higher, set pricing. It does not, however, reduce the risk of farmers exiting from sericulture. In fact, due to the average Nepali's dependence on the government for stable pricing levels, it would actually raise the likelihood that they will quit sericulture and return to their respective subsistence products.

Issue 3

DIFFERING GOVERNMENT AND PRIVATE SECTOR INCENTIVES

Nepal's government receives aid based upon the country's overall cocoon output. It is for this reason that the Khopasi center grossly overestimates the production volumes for the country. Astute students will realize this point as they review both Exhibits 3 and 4. Since it can be assumed that No-Frills Consultants has no vested interest in tainting the production numbers, their estimates are naturally more believable.

In addition, a student might bring up the question about HMG's denial to provide Surya with information about the value of the reeling unit. In the situation's actual development, the numbers were not given to Surya because Mr. Kafle was interested in getting a high value for the reeling unit. If he received a high bid, he would not have divulged the unit's worth. If, on the other hand, he received a low bid, he would have presented the unit's true value to Maggie so that she would be forced to raise her offer.

The overriding point is that, although governments may be formally committed to privatizing some of their operations, bureaucrats who are unwilling to give up some of their own authority may still build substantial roadblocks to private sector success.

Other options that students might examine are very close to this option and include using market pricing levels along with the following:

- Leasing the equipment from Khopasi for almost any price,
- Purchasing Khopasi's unit for only the NRs. 100,000 payoff to Mr. Kafle,
- Acquiring Khopasi's unit for no cost, and
- Acquiring Khopasi's unit for the Indian price and giving Mr. Kafle his NRs. 100,000 payoff.

In addition to these options, students might attempt to push profitability to its maximum value by performing any or all of the following options:

1. Changing the cocoon purchase price to the Russian level (US\$1 or NRs. 50) and keeping the reeled silk selling price at virtually any level. Obviously, this will increase profitability tremendously, but is not sustainable because of Russia's general instability as a supplier.
2. Using historical pricing levels given in *The Hindu* article. This will show that silk reeling is extremely profitable when market pricing levels are allowed to dominate.

Scenario 4—Two-year Break-even Analysis

Some enthusiastic students might even try to analyze how high raw material costs will be allowed to climb, given the current reeled silk selling price.

ANALYSIS OF OPTIONS AND EVALUATION BY STUDENTS

The instructor should consider leading the class through an evaluation of investment options by asking several volunteers to outline the scenarios they evaluated. The students might additionally put their evaluations of cash flows on the blackboard or other medium and present their conclusions for each scenario.

The objective of this exercise is not to evaluate the students' actual analyses of the scenarios, but rather, their ability to deal with the conflicting information and conflicting goals of the government and private sectors in this privatization. Conversations about the overall situation should be promoted and lively discussion about all of the above listed issues should occur. Some

issues that outline the current business and economic climate in Nepal are presented in the case and are summarized in the Issue 4 box.

Issue 4

UNIQUE ASPECTS OF BUSINESS DEALINGS IN NEPAL

Some minor yet interesting points about Nepal's socioeconomic condition are given below. These bits of data are meant entirely to arouse students' interest about the country and do not have a truly significant impact on the overall outcome of the case:

1. Ghale and Surya's other farm workers will receive extremely high salaries by Nepali standards. With the average Nepali making \$170 per year, Surya's farm workers appear to be doing well at \$260. On the other hand, students might be surprised that Mainali, a Masters level graduate, would only be making \$70 per month.
2. Although water bills appear low by American standards, imagine how much of a financial burden it would be for a Nepali making \$170 per year to spend an average of 2 cents for one shower.
3. The electricity load sharing program in Nepal may be of interest to students who have not experienced brownouts before. The instructor might ask them to imagine having the lights go out in their businesses for four hours every other day.

Conclusion and Post-Case Events

Given the questionable profitability of acquiring the reeling unit, the difficulty in dealing with HMG, and the potential loss of raw material inputs as market forces take over, Surya decided not to invest in the reeling unit at this particular time. The company decided to push the decision out for one additional season. By doing this, Surya would be able to force the Khopasi SDP center to make its own decision about its reeling unit (closing it down if that became their intent). That would eliminate all domestic markets for the farmers' cocoons.

As of this writing, Maggie had successfully pushed HMG to the brink. Mr. Kafle had committed to his supervisor, the Minister of Agriculture, that he would get out of silk reeling business. The Minister had, in turn, negotiated with the South Korean government to change Nepal's aid program so that the Nepali government need not continue reeling silk. Given the restructuring currently underway at HMG, Maggie placed Surya in a stronger bargaining position than they held at the time of the case.

Note

¹This case was prepared by David L. White with the assistance of Dr. Michael Ginzberg of the Weatherhead School of Management, Case Western Reserve University; and Dr. Richard Linowes of The American University. It is based on experience acquired during a 10-month assignment in Nepal with Surya Silks (Pvt.) Ltd., and on published sources and interviews with parties within Nepal's silk industry.