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Case study: Misleading satellite data contract

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Case (for presentation to students)

Jim Willis was the Vice President of Marketing and Sales for International Satellite Images (ISI). ISI had been building a satellite to image the world at a resolution of 1-meter. At that resolution, a trained photo interpreter could identify virtually any military and civilian vehicle as well as numerous other military and non-military objects. The ISI team had been preparing a proposal for a Japanese government contractor. The contract called for a commitment of a minimum imagery purchase of $10 million per year for five years. In a recent executive staff meeting it became clear that the ISI satellite camera subcontractor was having trouble with the development of a thermal stabilizer for the instrument. It appeared that the development delay would be at least one year and possibly 18 months. When Jim approached Fred Ballard, the President of ISI, for advice on what launch date to put into the proposal, Fred told Jim to use the published date since that was still the official launch date. When Jim protested that the use of an incorrect date was clearly unethical, Fred said,

> "Look Jim, no satellite has ever been launched on time. Everyone, including our competitors, publish very aggressive launch dates. Customers understand the tentative nature of launch schedules. In fact, it is so common that customers factor into their plans the likelihood that spacecraft will not be launched on time. If we provided realistic dates, our launch dates would be so much later than those published by our competitors that we would never be able to sell any advanced contracts. So don't worry about it, just use the published date and we will revise it in a few months."

Fred's words were not very comforting to Jim. It was true that satellite launch dates were seldom met, but putting a launch date into a proposal that ISI knew was no longer possible seemed underhanded. He wondered about the ethics of such a practice and the effect on his own reputation.

The Industry

Companies from four nations, the United States, France, Russia, and Israel controlled the satellite imaging industry. The US companies had a clear advantage in technology and imagery clarity. In the US, three companies dominated; Lockart, Global Sciences, and ISI. Each of these companies had received a license from the US government to build and launch a satellite able to identify objects as small as one square meter. However, none had yet been able to successfully

launch a commercial satellite with such a fine resolution. Currently, all of the companies had announced a launch date within six months of the ISI published launch date. Further, each company had to revise its launch date at least once, and in the case of Global Sciences, twice. Each time a company had revised its launch date, ongoing international contract negotiations with that company had been either stalled or terminated.

Financing a Satellite Program

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

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

The Current Problem

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

ISI had been negotiating with HTC for the past six months. It was no secret that HTC had also been meeting with representatives from Lockart and Global Sciences. HTC had sent several engineers to the ISI to evaluate the satellite and its construction progress. Jim Willis believed that ISI was currently the front-runner in the quest to sign HTC to a $10 million annual contract. Over five years, that one contract would represent 1/6th of the contracts necessary to insure sufficient venture capital to complete the satellite.

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

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

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

Resources for teachers

Suggested discussion points

1. Which of the GISCI Rules of Conduct pertain to this case?
2. What are the factors which have created the ethical dilemma?
3. Is it ever appropriate to withhold negative information from the client?
4. What should ISI do?

Relevant GISCI Rule of Conduct

Section II, Number 8: “We shall describe our products and services fully, accurately, and truthfully; we shall honestly describe the capabilities of products, systems, or services with which we are concerned and shall not take advantage of the lack of knowledge or inexperience of potential clients or employers.”

Teaching note

Overview

Jim Willis was the Vice President of Marketing and Sales for ISI, an aerospace company. His boss, Fred Ballard, had asked Jim not to disclose a change in the launch of ISI’s high-resolution satellite due to a problem with the camera. Fred’s rationale was that disclosure would have a negative effect on contact negotiations and might result in severe financial repercussions. Further, Fred suggested that it is standard industry practice to withhold negative information. Jim believed that not disclosing the information might be unethical, and was wondering what to do.

Teaching Objectives

1. Provide students with an understanding of the internal and external factors which cause managers to be placed in ethically compromising positions.

2. Evaluate and determine an ethically responsible course of action for ISI.

3. Offer students an opportunity to identify and evaluate possible positive and negative ramifications to the course of action that they have selected.

General Discussion

The type of situation discussed in the case is unfortunately not uncommon. Sales people are routinely asked to withhold information concerning shipping delays, production delays, possible labor unrest, product quality issues, and other customer relevant information. One of the greatest threats to a sales person’s personal integrity and long term relationship with clients is pressure from within their own company to withhold relevant information. The fear of loosing contracts, income, and job status often cause members of a firm to act outside of integrity. Recent cases like Enron/Arthur Anderson (Berenbeirn, 2002) have brought to the forefront how pressure to succeed can influence decision makers and subordinates alike into unethical decisions

Questions

1. What are sources of the factors, which have created the ethical dilemma? There are several internal and external forces at work here.

Internal forces include:

- Jim Willis' boss, Frank Ballard, has given Jim a specific instruction not to disclose the information.
- the company code of conduct does not permit the disclosure of company proprietary information without prior approval.
- the financial health of the company could be jeopardized.
- Jim Willis' personal financial well being could be jeopardized.

External forces include:

- industry practice is to publicize optimistic completion dates that are rarely met.
- the financial industry that has profitability expectations which may be impossible to meet if realistic information is provided.

2. Is it ever appropriate to withhold negative information from the client?

The answer is, it depends. Potential problems with production, delivery, and maintenance arise all the time. Most of these problems are solved without any customer impact. It is neither productive, nor reasonable to bring all of these problems to the customer's attention. However, when a known problem has the likelihood of having a severe negative effect on a customer, it is the company's responsibility to disclose this information. Numerous illustrations in the consumer arena are testaments to the effect of failure to disclose. Ford Pinto gas tanks and Firestone tires (Miller, 2000) had serious negative effects customer. Cases like Tylenol (Stevenson, 1986) suggest that early disclosure can actually improve customer perception and loyalty.

3. What should ISI do?

As the epilog illustrates, the customer was savvy enough to provide safe guards against industry practice and the deal did not go through until much later than planned. While there is no information as to whether or not the same ordering delay would have happened if Jim Willis had disclosed the information in advance of the negotiations, it was clear that the level of trust between the parties was very low since the Japanese insisted upon completion guarantees. Therefore, it can be surmised that in this case, disclosure could have afforded the two parties the opportunity to work more closely together and in the end helped ISI to close the contract earlier, on better terms. Therefore, in this case, ISI should either have disclosed the negative information or delayed negotiations.

Teaching Suggestion

We like to treat this case as a role-play and assign students to play the roles of Fred Ballard, Jim Willis, a venture capitalist, and the customer. Each is to make a case for his or her point of view. The class then has an opportunity to comment on what should be done. Since no new firm date has been determined, a reasonable case can be made for withholding all date information from the client until a firm date has been be established. The question will be whether the customer

should be apprised, perhaps under non-disclosure, of the technical problems and given the opportunity to continue negotiations or delay.

Epilog

In the actual case, the date was not initially disclosed to the customer. However, the customer insisted that if the launch date was missed, the customer had the right to renegotiate the terms of the contract or void it all together. Further, the customer insisted that any ISI software purchased by the customer would be fully refundable if the satellite did not launch within six months of the launch date. Under these circumstances, ISI was forced to disclose that the launch date was in jeopardy. At that point, contract negotiations were suspended for more than a year. Other potential contracts were also put on hold. Although contracts were finally negotiated, it was not until after ISI went through bankruptcy and reorganization. Neither Jim Willis nor Fred Ballard was with ISI when the satellite finally launched. The actual launch took place five years after the original launch date. As Fred Ballard had predicted, all competitor launch dates were similarly delayed.

Epilog 2

In 2004, the US government announced its intention to purchase commercial satellite imagery worth over $500,000,000. The contract would fund the production and launch of a new spacecraft. Imagery resolution would be less than .5 meters. The leading contender for the contact entered one-on-one negotiations with the US government. Negotiations broke off after the two sides failed to iron out financial terms and negotiate a “realistic” launch date. The satellite company had provided a launch date that they believed was realistic but which fell beyond the schedule the government agency requested. Industry experts knew the government agency’s launch date request was not realistic.

ISI had just emerged from bankruptcy protection and had launched its first high-resolution satellite (which had sensor problems and was unable to deliver planned image quality). Even though ISI was the weakest contender for the contract, they were awarded the contract. They were awarded the contract primarily because they agreed “comply” to the government spy agencies required launch date.

The question of ethics remains. One company truthful in its bid for the contract disclosed that it could not make the required launch date – they lost the contract. The other company agreed to the launch date requested in the contract even though it is extremely unlikely that they would be able to build and launch the satellite on time, and won the contract.

Less than six months after the contract award the winning company purchased the other company. ISI’s satellite is believed to be behind schedule.

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