Vendor Gifts at Indian Trails Country Club: An ethical dilemma

By Galen Collins

Introduction

Indian Trail Country Club revenues and profitability grew substantially during the first three years of Tom LaFranz's tenure as general manager (GM). However, in subsequent years profits declined significantly, triggering an investigation by the club controller. The investigation revealed that the food and beverage cost percentages had gone up significantly due to increased vendor prices. Two vendors accounted for most of the increase, both of whom had given Tom high-value gifts. Various stakeholders weighed in on the issue. The case study scenario provides the details of the food and beverage department performance and its relationship to vendor gift-giving. It concludes with several discussion questions to help the reader reflect on and analyze the issues presented in the case. The purpose of this case study is to help readers develop a framework for interpreting and assessing ethical issues.

Background Information

Indian Trails Country Club has a championship par 72 golf course and a clubhouse with a 20-seat bar and lounge, 100-seat restaurant open for lunch and dinner daily, and banquet facility that can accommodate groups up to 80. It regularly hosts weddings, gourmet dinners, wine tastings, dances, and special events. The club is located in a village in southeast Florida that is fifteen miles inland from the Atlantic Ocean. It was built as a centerpiece of a residential community by the Lincoln Real Estate Group (LREG), a real estate development corporation listed on the New York Stock Exchange.

The Executive Vice President of LGREG, Marty Katz, hired Tom LaFranz to be the opening GM of the Indian Trails Country Club. Tom's previous club experience was entirely at a large country club and golf resort in Miami, Florida. He started as a dishwasher and eventually worked his way up to clubhouse manager reporting to the GM, Vince Jones. Vince took Tom under his wing and taught him the ins and outs of the club business. He liked Tom's work ethic and found him to be a quick study. Vince was grooming him to be the next GM when he retired. But that never happened. The club board of directors hired an outsider. They felt that Tom was not experienced enough to handle the variety of demands of a large club, so Tom looked for GM opportunities at smaller clubs. When Marty Katz interviewed Tom, he was immediately impressed with his presence. Tom was articulate, well dressed, professional, and enthusiastic. Tom was passionate about the club business and had strong aspirations of becoming a successful country club GM. When he was hired to become the GM of Indian Trails Country Club, his career dream became a reality, and he hit the grounding running. He was liked by both club members and employees because of his considerate and consistent personality that always put them at ease.

Galen Collins *is affliated with Northern Arizona University.*

Operational Costs Rising

The Indian Trail Country Club revenues and profitability grew substantially during Tom's first three years. However, beginning in the fourth year revenues plateaued while profits declined significantly. Maria Sanchez, the LGREG Chief Financial Officer, became concerned. The club bookkeeper, who had no previous club or hospitality work-related experience, could not pinpoint the cause of rising operational costs. And Tom, who had never been to college or taken an accounting course, was also dumbfounded by the decline in overall club profitability. Consequently, in 2008 Maria hired an experienced club controller, Mehmet Oz, who directly reported to her, rather than the GM, until the cost issues were identified and resolved. Mehmet's job responsibilities included:

- Developing and administering policies and procedures for accounting, budgeting, taxes, statistics, auditing and internal control.
- Maintaining the club's financial records.
- Evaluating club operations in terms of costs, economic trends, controls and profitability.
- Preparing analyses for managerial and administrative functions.

Rising Costs Investigated

Mehmet began the investigation with the food and beverage department, which was managed by Jill Wright. Jill had only been the club food and beverage director for only two months, so she was still gaining her sea legs. Jill told Mehmet that the food and beverage department was losing money and it was a permanent topic at every Board of Directors meeting. "That is not unusual," stated Mehmet. "The food and beverage operation is considered an amenity. That is why clubs charge dues." But we are losing too much money, and I'm not sure why," stated Jill. "OK Jill, let's perform a cost-to-sales ratio trend analysis (e.g., cost of beverages sold /beverage sales) to gauge financial performance and detect any anomalies (Newman, 2012; Dittmner and Keffee III, 2009) (see Table 1).

Table 1

Cost-to-Ratio Analysis

	2010	2011	2012	2013	2014
Food Cost %	39%	41%	39.5%	52%	53%
Beverage Cost%	30%	32%	32%	37%	38%

The analysis revealed that food and beverage cost percentages had gone up significantly in 2006 and 2007 and were considerably higher than the industry averages reported in the 2007 North American Edition of Clubs Town & Country: 38% and 32% respectively for food-cost and beverage-cost percentages (DeFranco and Schmidgall, 2008).

"I can now see why the food and beverage department is losing so much money," stated Mehmet "We have serious food and beverage cost problems." Yes, a puzzle to solve," replied Jill in a hesitating voice. "Where do we begin?" "When was the last time any vendor accounts were put up for bid?" inquired Mehmet. Jill responded: "Never." "Let's make this the first step," replied Mehmet. "I have a hunch we may uncover something."

Jill added a bidding module to the inventory control system for identifying the most economical products adhering to the purchase specifications and reviewing stored bids when selecting vendors for purchases. Jill discovered that the executive chef, Robert Delaney, selected the most expensive bids for meat products that involved one particular vendor, Miami-based Southeast Meat Company.

Jill asked Robert why he selected those bids. "Because they provide premium cuts of meat," he replied. "Southeast offers a wide array of meat and poultry products in a range of cuts and styles. And there is one more reason – Tom has a longstanding relationship with Southeast that goes back to his previous job. Wine and Spirits of America is another one."

Mehmet and Jill met with Tom. "Tom, we have discovered why the food and beverage department is losing money. Supplier prices, particularly for meats and alcoholic beverages, have increased significantly. Do you know which suppliers?" asked Mehmet. Tom looked chagrined. "I do not know." Mehmet replied: "Two suppliers accounted for most of the increase: Southeast and Wine and Spirits of America."

"I thought I had an excellent relationship with those two purveyors," stated Tom in a distressing tone. "They promised that they would provide fair prices. They are not honoring our deal." "The prices jumped in 2006," stated Mehmet. "Tom, what kind of relationship did you have with these vendors at your last job," inquired Mehmet. "It was great," responded Tom with a confused look. My GM at the last club did business with these vendors for 20 years. We were like family. We received Miami Dolphin football tickets, gift cards during the holidays, and a sampling of products for special personal occasions. "What about at Indian Trails?" asked Jill. "Yes, I still receive gifts from these two vendors and others too. In fact Southeast, gave me a $300 gift card this past Christmas, along with some Miami Marlin tickets. Wine and Spirits of America paid for a Napa Valley wine vacation last year to boost my knowledge of fine wines and food pairings."

Mehmet called Maria about his conversation with Tom. She later discussed the findings with Marty. "I'm very disappointed in Tom's judgment," stated Marty somberly. The club members love him but he took kickbacks resulting in higher supplier prices, undermining the financial stability of the club. "I'm not sure that he understands the implications of his actions," stated Maria. "Maria, I want you and Mehmet to meet with the club board of directors before we make a decision to either retain or terminate Tom."

Board of Directors Meeting

Maria and Mehmet met with the board on an early Friday morning to present their findings concerning Tom's relationship with vendors and the impact it had on the financial performance of the club.

Board Member A: I can't believe that Tom accepted kickbacks. That is illegal. He needs to be terminated.

Board Member B: Accepting kickbacks is not illegal. It is a conflict of interest and grounds for severe disciplinary action and perhaps dismissal, especially if it is hurting the club financially.

Board Member C: I've worked in the restaurant business and it is common for vendors to give gifts. No big deal.

Board Member D: Yes, it is no big deal if it is ham or turkey around the holidays but a paid wine vacation! His behavior is unethical. At the very least, he should be written up.

Mehmet: Vendors gifts were common at Tom's former employer.

Board Member E: Well it is evident the club has ended up paying a higher price on vendor products as a result of these gifts.

Board Member C: Do we have a policy about what is appropriate or not appropriate for employees to receive from vendors in the form of gifts?

Maria: There is no written policy regarding relationships with vendors. I think we have two fundamental issues concerning Tom's situation (Markkula Center for Applied Ethics, 2008):

1. On what do we base our ethical standards for the club?
2. How do these standards get applied to specific situations employees face?

Board Member C: Herein lies our ethical dilemma. Standards for what constitutes ethical behavior may lie in a "grey zone." Clear-cut right-versus-wrong answers may not always exist (Sims, 1992). There are many factors to consider (see Table 2).

Table 2

Summary of Case Evaluation Factors

Vendor Gifts	Tom LaFranz	Organizational
Value Purpose Industry Accepted Practice Legality Taxability Ethicality	Ethical Awareness Learned Behaviors from Past Employment Intentions in Receiving Vendor Gifts Job Performance	Internal Accounting Controls Vendor Gifts and Cost Consequences Organizational Policy and Response to Ethics Violations Code of Ethics Ethics Training

Discussion Questions

1. Are vendor kickbacks, receiving anything of value to influence a business decision, illegal?
2. Did Tom receive gifts or kickbacks?
3. Did Tom maintain ethical relationships with the vendors based on his intentions, the consequences of his actions, and/or industry practices? If not, what disciplinary action would you recommend?
4. What can be done to prevent the case's ethical dilemma from happening again?

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