Confidential Instructions for Bacchus Role

Bacchus is a successful winery, with 63 fully owned vineyards scattered throughout the US (although the majority are located in California). Bacchus was founded some 20 years ago, and appears to be a successful and growing company, as they have maintained a strong market share, specializing predominantly in high-end wines, although they also produce some moderately priced wines. Bacchus consistently wins prizes for their wines, both nationally and internationally, with their wines holding up well to French wines in Western Europe, at least outside of France itself.

Tokyo Saki produces sake and rice wines, various Asian beers, as well as a line of alcoholic ginseng products (previously acquired from a Korean company). Tokyo Saki has strong market share within Asia, and has been making inroads as a novelty product, especially with its ginseng lines, in Europe and North America. At least part of the success of the ginseng lines has been due to the common belief that the ginseng root prevents the negative effects of alcohol on the system (such as liver damage due to over-consumption) and has long been recognized for its medicinal and curative powers in Asia, and more recently in Europe and North America.

Serbian Steins & Stems specializes in fine decanters, wineglasses, and accessories. More importantly, however, they recently patented a new process that makes fine, delicate crystal and porcelain virtually indestructible, while maintaining its beauty and fragile appearance. This development has obvious customer appeal, but also significantly reduces the expenses associated with shipping breakage and the like. If costs can be reduced on the process, it may even be feasible to use the technique for bottling, making it attractive as a virtually unbreakable bottle for wine and beer, as well as other products. Tokyo Saki recently acquired a small stake in Serbian Steins & Stems, hoping to complement its offerings with the accessories that would appeal to the North American and European markets, thus bringing it into the merger talks in a three-way play.

Last year, Bacchus management made overtures to Tokyo Saki in an effort to acquire their full line. Tokyo Saki declined, but encouraged a discussion of a possible merger between the companies, including the possibility of Serbian Steins & Stems for contemplation. Such a three way merger might provide Bacchus with complementary products and a presence in high-potential markets, while providing Tokyo Saki and Serbian Steins & Stems with product visibility and distribution systems that include the lucrative U.S. market. With the increasing popularity of fine wines and accessories, as well as “New Age” herbal medicines, such a three-way merger provides a particularly attractive opportunity. However, there are risks. For example, Bacchus is not sure of the potential market for rice wine, as it is frequently considered too sweet by most North Americans, and may not fit well with the sophisticated image that Bacchus has worked hard to develop. There does appear to be a fledgling market for Saki and Asian beer, and especially ginseng products, with considerable potential. The instability of the political situation in Eastern Europe is cause for concern as well, in any deal involving Serbian Steins & Stems, as is the recent Asian financial crisis. Given the risks and possible benefits, Bacchus has expressed cautious interest in the possibility of a three-way merger, and these discussions led to a satisfactory agreement on price, however, there are several issues that are yet to be resolved. These unresolved issues have led to the present meeting between your executive groups. In preparation for the meeting, the three companies have already exchanged appropriate information and figures. Unfortunately, a merger between any two of the companies loses significant synergy and is considerably less attractive; hence it is important to negotiate an agreement that is satisfactory to all parties, if there is to be an agreement at all. At this time, the remaining issues to be resolved include:

- **Stock ownership** of the combined company that would result from a merger. The division of stock influences the amount of the annual profits that would accrue to each of the three respective companies. Ownership of the combined company is far and away the most critical issue in this negotiation for Bacchus. You believe that the difference in the appraised values of the companies' respective holdings entitles you to approximately 45% ownership of the combined company. Any deal that gives you less than 45% is simply unacceptable.

- **Control**, as represented by the number of voting seats on the 12-person executive board to be controlled by each company. While you are willing to have Tokyo Saki and Serbian Steins & Stems represented on your board, you do not want to allow them so many seats that they can influence the direction of the company by voting as a block. This kind of voting block could destabilize the delicate dynamics of the Bacchus board decision-making, and, given the fragility of consensus, might allow the other companies more power than a simple seat-tally would represent.

- **Management.** There are three management issues. ***First***, is the management of the company in each country? In order to capitalize on the strategic synergies, management issues are key, and it will be critical to staff each location appropriately. It has not yet been established whether each location would continue to run as they have been running, or whether the Americans will select and send general managers, or whether there will be some form of exchange program or cross training of managers. You are pretty sure that the application of good old American cost controls and yield management will boost profits substantially. You would like to see experienced managers with a proven track record in place, but you are willing to consider other approaches to the consistency and management efficiency problems. The ***second*** issue is what to do about Nikko Raspovliac, the son of the founder of Serbian Steins & Stems. It is your understanding that he is completely incompetent and abusive of his employees. In addition, there are rumors that he has been embezzling and that he is prone to bribe government officials and key employees of other organizations. Even if you could place him in a rather innocuous and powerless position (such as a position in name only) where his incompetence would not be a factor and his sticky fingered tendencies (if any) would be in check, it would still be problematic. Finally, the ***third*** issue is management incentives, or how to motivate the management teams towards the common goals of the merged companies. You prefer to pay your managers contingent on performance. Although you are willing to provide some salary, you prefer that a large part of each manager's compensation be paid in the form of a contingent bonus. Past experience indicates that this can substantially increase performance

- **Form of the agreement** is also quite important. You are dealing with the laws and norms of three different countries; hence it is important that the agreement be clearly specified. During the previous negotiations, it has seemed at times as if Serbian Steins & Stems has not been forthcoming or particularly helpful. In addition, given the political situation and corruption of most Eastern European countries (perhaps a legacy of the days when they were under the control of the Soviets), you are worried about a potential lack of good faith – that they may not intend on honoring the agreement, if one is struck. It is also the case that corruption and bribes played a part in the economic problems recently experienced by Japan and the rest of Asia, so there is some concern there as well. You simply cannot afford to take a chance. Consequently, it is important to you that any agreement that does result from these negotiations be ironclad, so that they cannot back out or renege on the agreement. A contract that specifies not only the agreement, but also the penalties for failure to honor any part of the agreement is quite important to you.

- A final issue is **timing** – you need to close this deal and return as soon as possible to headquarters. Given other opportunities, a long, drawn-out negotiation will not be acceptable this time. If you turn in a written and signed contract in 20 minutes under the deadline, you will receive 20 points. If you turn in a written and signed contract in less than 20 minutes under deadline, but still under the deadline, you will receive 10 points. If you turn it in at the deadline, you will receive zero points. For every 10-minute period (or part thereof) that you exceed the deadline, you will lose 10 points.

To help you in your negotiations, your team has constructed a table (attached) of the issues and devised a point scheme to help you prioritize among the issues and select the optimal agreement – all you need to do is to "maximize" your point value and you will have the best agreement for Bacchus. Note that the point scheme represents a one-time estimate of the combined long-term financial and symbolic impact of any deal component. **To assess the total value of any offer, add up the points assigned to each component of the "package."** You must assume that the value estimates of each settlement are accurately represented.

Do not show this table to anyone else, nor should you reveal specific pay-off information!

Issue:	Spread:	Minimum	Maximum
Stock Ownership	1060	-500	560
Board Seats	556	-500	56
Management Staffing	70	0	70
Nikko Raspovliac	300	-200	100
Management Compensation	100	0	100
Form of Agreement	200	50	250
Timing	20	0	20
	Total:	-1150	1196

Evaluation of Negotiated Agreements for Bacchus	
Issue	**Point Value**
Bacchus Stock Ownership[1] less than 45%	500 point ***loss***
each % *above* 44% is worth:	10 points
Control (Bacchus seats on Board)[2] fewer than five seats	500 point ***loss***
each seat above four is worth:	7 points
Management Staffing: Upper level management in each location to:	
be locally staffed (polycentric)	0 points
be staffed by best management, regardless of nationality (geocentric):	50 points
at least one manager from the non-local countries:	70 points
include proportional representation from all three countries:	60 points
Nikko Raspovliac: fire him	100 points
buy him off (he leaves firm)	70 points
place him in powerless position	20 point ***loss***
retain as management	200 point ***loss***
Management Incentive: less than 5% of pay contingent on performance	0 points
5% - 15% of pay contingent on performance	30 points
16% - 25% of pay contingent on performance	65 points
greater than 25% of pay contingent on performance	100 points
Terms of the agreement:	
flexible contract, that specifies only the general terms of agreement, & allows for modifications	50
specifically delineated contract, that suggests penalties for non-compliance	125
specifically delineated contract with clearly specified penalties for non-compliance	250
Timing[3]: Completion of the deal, with written & signed contract specifying the agreement *turned in*, in under 20 minutes under the deadline	20
Negotiation of the deal negotiated & *turned in*, in under the deadline (but less than 10 minutes under)	10
Negotiation of the deal complete at the deadline	0
For each 10 minutes the negotiation ***exceeds*** the deadline, ***subtract 10 points***	
Total	

[1] So, for example, if you negotiate 0 - 44%, you would receive -500 points, 45% you would receive 10 points, and for 50% you would receive 60 points.

[2] So, for example, if you negotiate one seat, you would receive -500 points, for five seats, you would receive 7 points and for eight seats you would receive 28 points.

[3] So, for example, if you have 30 minutes to negotiate and turn in your contracts at the 9 minutes, you will receive 20 bonus points, for 10 minutes through 19 minutes under the deadline, you will receive 10 points. If you exceed the deadline by 1 - 10 minutes, you will lose 10 points. If you exceed the deadline by 11-20 minutes, you will lose 20 points, and so on.