

## COLOREANDO S.A. de C.V. (A)

*Case developed by  
professor **Gabriel  
Hidalgo Moreno**, of the  
Marketing Management  
Department of the  
Instituto Panamericano  
de Alta Dirección de  
Empresa, in  
collaboration with  
**Enrique Trozzo  
Francese**, for it to be  
used as basis for  
discussion and not as an  
example of adequate or  
inadequate management  
in a specific situation.*

On December 26, 2000 Roberto and Jorge Córdoba got together to decide how to respond to the unusual request made by the marketing department, calling for nothing less than a share in the company's ownership. This was happening when the company found itself in trouble for the first time in its history. It appeared the request had been orchestrated and timed by the leadership of the marketing department. The attitude of the salespeople and their manager posed a major threat to the company's future. Thus Roberto and Jorge needed to respond immediately. The only clear thing was that the company needed to begin 2001 on a different path.

Roberto: "What are we going to do? We can't begin the new fiscal year without making a final decision."

Jorge: "I would really like to take extreme measures to address this situation. But we must be cautious and consider what is best for the company's future."

### The Company

In May 1991, two siblings, Roberto and Jorge Córdoba, aged 26 and 24 respectively, cofounded the printing company Coloreando S.A. de C.V. in the city of Guadalajara. Both of them had recently finished their university studies and complemented each other in spite of having very different personalities. Whereas Jorge was orderly, conservative and frugal, Roberto was little disciplined and somewhat spendthrift, but very audacious with clear vision. Over time, this combination propelled Coloreando to achieve strong and rapid growth while taking moderate risks.

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The company's objective had been at first to print all kinds of paper and cardboard products. Coloreando's distinguishing features were excellent service, high quality print, and on-time delivery. On-time delivery was a major selling point because most printing companies in Mexico were famous for late deliveries.

From the beginning, the partners considered technology and people as the main pillars of the organization. Therefore, they set out to recruit people with outstanding technical and human quality. Concerning technology, there were four printing firms in Mexico (none of which was in Guadalajara) with modern printing equipment: two of them focused on "commercial printing" (e.g., brochures, magazines, catalogues and advertisement in general) and the other two served the packaging market (e.g., cardboard boxes and labels). The average age of printing equipment in the industry was 23 years, partly because real change in printing technology had only recently taken place for the first time in 30 years, when electronics and the alcohol system were introduced to the industry's *offset* system.

Consequently, the company made a huge investment in state-of-the-art printing equipment, albeit smaller than the equipment of its main competitors. The best printers in Guadalajara were hired and trained to operate the new machines. Coloreando began operations printing any type of work on either paper or cardboard. Since the partners had no clear idea of the market segment the company should focus on, Coloreando took on a wide variety of printing jobs, from advertisement and labels to cardboard boxes and magazines requiring small runs (Exhibit 1a).

## Strategy

In 1992, a few months after starting operations, the partners revised their strategy and found that the company could not be competitive in every niche. Consequently, it was necessary to focus on a market segment and create unique value proposition for the chosen segment based on clear differentiating factors.

The packaging market consisted of two customer segments: first, companies who did not care much about quality, a segment controlled by printing houses which had completely depreciated equipment and cheap labor; second, companies that cared about quality and usually requested very large runs. In both cases, price was a key decision variable since packaging was part of a product's direct cost.

The partners realized that Coloreando could not be competitive in any of the two segments in this market. In the first one due to the company's high-tech and high quality labor, in the second segment because competitors that had the same type of technology also had bigger equipment, which enabled them to cut production costs thanks to larger scale operations.

Consequently, the partners decided in early 1992 that the company should focus on the high quality printed advertisement market that required small to mid-sized print runs (1,000 to 15,000 copies) and adapt to the existing capacity, since reliability and meeting delivery deadlines were the minimal competitive requirements. The question that was immediately raised was how to add value to the product in order to price products higher than the competition without losing attractiveness and competitiveness, since it had become clear, as already mentioned, that neither punctuality nor quality would be enough to achieve this objective.

The partners thus agreed that the company's strategy would focus on adding value in the chain through rendering an "integrated service" to meet all printing needs of their potential customers. It was with this vision that a computerized originals design and assembly department was created, and partnerships with the best local photographers were formed, so that customers requiring printed advertisement would no longer need to engage an advertisement agency and would be able to save substantial amounts of money,

with Coloreando capturing this value in the process (Exhibit 1b). This integrated service proved innovative since no printing firm offered this type of one-stop service in the entire country.

### *The Sales Function*

The partners considered hiring a salesperson to run the marketing department. It was important to decide the ideal profile for this role as the partners were convinced that he or she must be able to engage the buyer and key decision makers in buyer firms. In the packaging industry, procurement departments usually made buying decisions. Yet because of the integrated services offered by Coloreando it was very likely that such decisions were made by the marketing department in large companies, or directly by the owner in small and mid-sized businesses. Consequently, the partners decided to recruit an executive with a high social and cultural status. A professional who had graduated from one of the country's best universities, capable of engaging c-suite executives and endowed with outstanding negotiating skills and high financial aspiration. Accordingly, the compensation package offered would be highly competitive. They offered an 80:20 split between variable and fixed pay. The variable portion depended on a 5% commission rate on sales. The new hire filled the plant's installed capacity with purchase orders in less than a year, selling at prices well above those of competitors, a fact that allowed Coloreando to become profitable in the short term and double production capacity in less than three years.

### **Integration and First Stage of Growth (1994-1996)**

Owing to increased production capacity, it became evident that hiring more salespeople was necessary. Given the higher than expected results achieved with the current salesperson, a decision was made to recruit two additional salespeople with the same profile and compensation plan. All three salespeople would report to the partners (Exhibit 2a). The idea was that the three salespersons would end up earning highly competitive but similar pay.

Results were better than expected. Sales grew rapidly and the gross margin was in excess of 60% thanks to the medium to high prices that customers were prepared to pay. This allowed the partners to continue investing heavily in new equipment without having to borrow funds.

It was obvious for the partners that Coloreando's success was largely due to the strategic decision of offering an integrated one-stop shop and focusing on a market segment, in addition to providing high levels of customer service and product quality. In keeping with this approach, the partners implemented a new strategy of full integration in early 1994, aiming to carry out the entire process within the company's premises. This made it unnecessary to outsource any process at all, including those which were more cost-effective if outsourced, since this was the only way of offering a high level of reliability and on-time delivery, as well as greater flexibility in providing urgent special services when the size and importance of a customer required it (Exhibit 1b). The new strategy presented a great challenge because the different kinds of equipment needed to perform each and every process for making a product involved substantial investments. These were made over a three-year period with the goal of acquiring the best technology available in the world.

Coloreando was doing very well. Even the threat posed by "the Mistake of December" 1994 helped the company a great deal since it had no financial liabilities and was serving a number of foreign companies which had dollar-denominated investment budgets and were capable of spending twice as much as in the past thanks to the devaluation of the Mexican peso. The crisis was forcing companies to invest more money in promotion and advertisement in order to increase their share in a market that was becoming increasingly smaller and at least maintain sales at current levels. Moreover, in order to secure a fixed price, many companies decided to pay in advance for the printed materials they would be using several months later.

## Second Stage of Growth (1996-1999)

### *Phase I*

Both the results achieved and the knowledge of the business which the partners had so far developed encouraged them to reconsider whether they should keep their focus on a single segment of the market or expand into a new one. They finally decided to do the latter, once again doubling Coloreando's printing capacity in 1997 (see Exhibit 1c), this time by means of very large printing machines that would enable the company to serve the large print runs segment (15,000 to more than 1 million copies). To acquire this equipment the company paid 15% of its value in cash, and applied for its first loan to pay the remaining 85% to a German supplier who had offered very convenient purchase conditions.

### *The Sales Function*

These changes prompted the partners to recruit three additional salespeople with the same profile as the first three. The new hires also got the same pay package. A marketing manager position was created (Exhibit 2b) and the first sales executive hired was asked to occupy this role. To compensate him for this added responsibility, the partners promised the marketing manager a 1% commission on sales made by his team (consisting now of five people) and in addition to keeping his portfolio of customers under the existing compensation plan. His total salary increased considerably. The marketing manager's duties were also expanded. According to his new job description, he was now to perform managerial tasks such as coordinating, overseeing and supporting the sales team, but his main objective was to keep sales growing at the same pace as before and develop a marketing strategy that took the periodicity of served markets into consideration.<sup>1</sup>

The results of the new strategy were outstanding: sales kept growing, margins remained high and fixed costs practically unaltered. This helped create enough resources in the following years to pay off the German loan in advance and invest capital in raising the level of compensation and the working conditions for the entire staff through a two-pronged plan:

1. Increase fringe benefits awarded to all of the employees. The most significant of these benefits included building a dining hall, granting life and health insurance, instituting a trust (to which the company contributed large sums of money) to encourage savings, designing a system of financial incentives for employees who met set goals, offering English language classes to anyone interested, and increasing the length of vacations and the size of Christmas bonus.
2. The workday of white-collar staff was reduced because these employees had been working extremely long hours because of their commitment to the company. It is worthwhile pointing out that, since the company required highly trained workers, more than half of the staff were white-collar employees, some of whom had technical schooling and many others even a university degree.

The purpose of this plan was to share the wealth that everyone had created, as the partners felt that if customers were to be treated with excellence, employees should be treated in the same way, since employees were Coloreando's most valuable asset. It is useful to mention that the sales force did not benefit from any of these plans. Since their wages varied and were directly tied to the results they achieved, the partners thought that it was not necessary to include them in the fringe benefits package. One more reason to do so was that the salespeople belonged to a socio-economic class considerably higher than that of the

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<sup>1</sup> Customers in the textile and shoe industries, for example, ordered their catalogues twice every year (Spring-Summer and Fall-Winter). The hotel industry increased its printing orders in February and March, before the Acapulco *tianguis*.

rest of employees and earned a lot more money than they did, and so the partners believed that the sales force would not have any interest in the fringe benefits being offered to the rest of the company.<sup>2</sup>

The marketing manager asked the partners in early 1998 to consider providing company-owned cars to the salespeople as they had to use part of their incomes to cover travel expenses. He also requested life insurance similar to those that had been provided to the rest of the staff. In order to recognize the performance of the sales department, the partners decided to grant them the following: major medical insurance, life insurance, and midsize equipped cars. Regarding their salaries, the partners decided to continue using the same variable compensation package as before.

### *Phase II*

Shortly after implementing the new fringe benefit plan company-wide, the marketing manager was informed of a new step in the strategic plan for this stage of the company's growth, namely, the decision to acquire additional equipment to double the printing capacity. The marketing manager was to prepare a sales growth plan to capitalize on the increased capacity.

After a week of long meetings, the marketing manager submitted an action plan that laid down a new marketing organization as follows:

- a) Recruit, for each salesperson, an administrative assistant who is knowledgeable enough to prepare quotes, orders, collections, and stay close to customers during the process of fulfilling their orders so that the sales force could focus on what they do best: "selling."
- b) Create a project management department that would have an employee per salesperson and a department manager. The job of this new department would be to follow up on the entire process involved in fulfilling each order and keep the sales assistant permanently informed of this follow-up.

Both the sales assistants and the members of the project management team would be paid a fixed salary with no commissions, and would report to the general manager (see Exhibit 2c). The marketing manager claimed that this organizational structure would help increase sales in accordance with the required growth plan without affecting the excellent service rendered to every customer.

But the partners believed that this plan would increase fixed costs considerably. However, owing to the good results achieved so far and the size of the challenge being faced, they thought the plan was reasonable and decided to implement it in 1999.

An additional step taken by the company was to channel resources into public relations activities with customers. A "Family Sunday" was organized at the initiative of the salespeople. Several salespeople and any customer who wished to attend with their families got together every Sunday at noon in a nearby farm to share a meal. Customers were free to join in whenever they wished, giving no previous notice. The purpose was to practice sports with their families.

The event was well attended by customers, to the point that it became a tradition. About twenty customers on average came together every Sunday, strengthening ties between the sales force and their customers, and creating bonds of friendship between them and their families.

This phase yielded very positive results in a short time and by the end of 1999, the installed capacity was being fully utilized, with three shifts every single day of the week including weekends. This again brought

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<sup>2</sup> A salesperson earned on average 100% more than the operations manager, and this difference was likely to increase to 120%.

benefits for everyone, as the company continued to make hefty profits and staff wages surpassed by far the industry average. The sales team made more money than they had ever imagined.<sup>3</sup>

Although each partner was acting as a general manager, Roberto focused mainly on production and Jorge handled administrative matters. The marketing management had been fully delegated to the first sales executive hired, and the only thing that Roberto and Jorge knew about customers was their trade names, seeing no reason to become directly involved with them because they were convinced that the marketing team had an excellent relationship with customers and offered them first class service. Furthermore, the marketing team was happy and loyal because of the warm and attentive treatment they received from the partners. For these reasons, Roberto and Jorge devoted their time to finding the best technology for each process in the plant. In addition, when they considered increasing the printing capacity, they had to consider balancing efficiency in the rest of the departments in order to solve bottlenecks, and this took up a great deal of their time. On the other hand, the partners spent lots of time making leisure trips and indulging in any hobby that crossed their minds. They enrolled together in a school for pilots, bought a yacht and began to practice several extreme sports, which was quite time-consuming as well. However, they also gave thought to their management development and decided to do a master's program in business administration.

Although all of this required them to spend increasingly longer periods of time away from the company, things were still going well for them. It should be pointed out that while there was no proper "general manager," communication was so good between the areas that this helped keep perfect order and profitability in operations.

### **Third Stage: Results (1999-2000)**

In November 1999 new printing equipment was acquired for Coloreando (Exhibit 1d), and so it became necessary to once more develop a sales strategy for a new growth phase. The goal was to grow sales by 50% relative to the previous year. While this posed a major challenge, it was considered manageable because of the top quality and first class service provided during the previous ten years. Moreover, the company had had to refuse serving new customers since it was operating at full capacity.

The marketing management designed the following plan:

- a) Maintain the existing marketing and support structures as well as the present procedures.
- b) Discard 400 "small customers" but acquire ten large ones which should have bigger buying potential than the deleted accounts.

"The time required to sell a \$50,000 or a \$500,000 project is the same. We need to optimize efforts. This is the way to achieve the goal," the marketing manager pointed out.

Management thought that the new strategy involved considerable risks. However, since the sales force was eager to try it out, management approved it and work began on choosing the 400 small accounts to be eliminated.<sup>4</sup> At the same time, Jorge and Roberto kept their focus on activities having to do with acquiring equipment to improve efficiency, as well as on expansion-related processes so as to avoid increasing the workforce.<sup>5</sup> For these reasons they attended every graphic arts exposition taking place anywhere in the world.

<sup>3</sup> Each salesperson was earning 120,000 pesos a month in average, without taking the value of fringe benefits into account.

<sup>4</sup> Customers who during 1999 had bought less than 150,000 pesos worth of products would be politely eliminated, giving them a convincing explanation.

<sup>5</sup> The company had a staff of 120 employees at that time.

But things did not go as expected and given their frequent absences from the company, the partners did not realize the depth of the problem until November 2000. In search of what went wrong, they thought that the sales force had probably reached their desired level of financial satisfaction or perhaps wanted other types of incentives. But the truth was that the salespeople did not appear motivated. Their assistants were the ones who were really working. Since the salespeople had trained these assistants, they were capable of completing by themselves the entire sales process with customers. This would not have been bad in itself had the salespeople devoted their time to acquiring new customers. Instead, they had barely overseen their assistants' work during the year, taking matters into their hands only if the situation required them to do so. Consequently, work in the sales department had consisted solely in taking orders from existing customers, with no effort aimed at acquiring new accounts. As a result, almost all sales made in 2000 had been repeat sales.<sup>6</sup>

An average of seven weekly telephone calls from potential new customers were received during that year, but these were poorly answered by salespeople, claiming "they're sold out." When a customer persevered and his or her inquiry was finally addressed by a salesperson, the customer was sent a quotation two weeks later in the best of cases. If in spite of the poor and delayed response, the prospect still wished to do business with Coloreando, the salespeople followed up on leads provided the leads had been qualified as "high potential" by the assistants.

When the rest of the employees became aware of this, a climate of real dissatisfaction began to develop. Everyone knew that the salespeople made a lot of money, but employees were equally aware that this was due to the efforts of the entire company. There prevailed a sense that the salespeople "spent the workday wasting time, making jokes about each other and making fun of everyone else –that's if they were around at all." This situation created conflicts between the sales force and the rest of the departments, resulting in deliberate failure to meet delivery deadlines so as to create trouble for the sales force. Service soon became a real disaster, and individual salespersons had to negotiate permanently with customers in order to not lose their accounts. New delivery deadlines were negotiated in exchange for discounts or some type of additional service. The staff had achieved their goal, i.e. to really put the sales force to work. Remarkably, most of the customers remained loyal to the company partly because of the good service and high quality products they had received in the past.

By June of the same year complaints had reached general management, both from customers and the marketing manager, who warned that it would be impossible to meet sales goals for that year if internal service continued to be so poor. Jorge and Roberto decided to personally take immediate measures, and as a result all of the operation problems were solved in less than two months, and the company was offering once again first class service. Moreover, in November the partners decided to make, for the first time in that year, a thorough revision of the overall results in the fiscal year, finding out that the outcome of the marketing strategy for the year was disappointing. For example, sales had dropped by 15% in December relative to the same month in the previous year, a time when the company had been completely busy because of the Christmas season. Sales in the last quarter had grown barely by 3% relative to the same period in the previous year, and taking orders pending to be fulfilled into consideration, Coloreando would end the year with a 12% growth, which considering inflation actually represented real negative growth.

As a result, the marketing manager was put under pressure for the first time in the history of the company, requiring him to: 1) do something to improve results, and most importantly 2) ensure a decent results in first quarter in 2001 that is consistent with installed capacity and the concessions made to the sales team. The marketing manager's response was "surprisingly impassive," and this prompted the partners to convene an urgent meeting with the entire marketing department (all five salespeople and their manager). They were

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<sup>6</sup> Since there was no control system in place, management became aware of the issue only by the end of 2000.

told to find a solution before year's end, and since only a few days remained, they had to forget enjoying their Christmas vacations.

The meeting was very short. In fact, it took a different turn because of a strange request made by the marketing manager, who declared as follows. "Growing sales is relatively easy. I personally know how to do that. We have done it before, so that is no big deal. However, we must first solve a different issue. We have been talking (by this he meant himself and three of his five salespeople) and want to ask you to consider handing over to us 40% of the company's stock in four equal shares, one for each of us."

Roberto and Jorge were completely baffled, and merely said by way of reply: "Such a serious issue calls for very careful consideration." The partners spent the next few days eight to ten hours locked up in their executive suite, trying to decide what action to take. The decision they had to make was really a difficult one, as the four marketing employees handled slightly more than 60% of Coloreando's sales.

Jorge and Roberto began to suspect (they were not sure) that the results of last semester's sales had been deliberately orchestrated to exert tremendous pressure on the company's leadership. Furthermore, of the list of ten large customers they had planned to acquire a year earlier, none had been acquired. Instead, they had gotten rid of nearly 400 accounts.

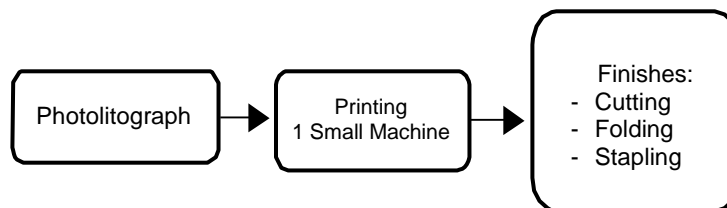
At that moment, Jorge and Roberto asked themselves a number of questions to arrive at a decision. Who owns the customers, the salespeople or the company? What percentage of the sales would be lost if it came to a break-up with the sales team? Who had taken part in designing the proposal: only the four salespeople? If we fire them, what should be done to keep the present customer base and grow sales to the desired level? Did these four employees really have that much power as reflected in their attitude? What should we do to prevent this from happening again? Moreover, most importantly, what have the partners done so badly if the company had always run so well?

The moment was right to do an analysis, as both the marketing manager and his team had decided to take vacations. This gave the partners the opportunity to move freely about the company, as well as a little time. But time was running out...

**EXHIBIT 1a**  
**COLOREANDO S.A. DE C.V. (A)**

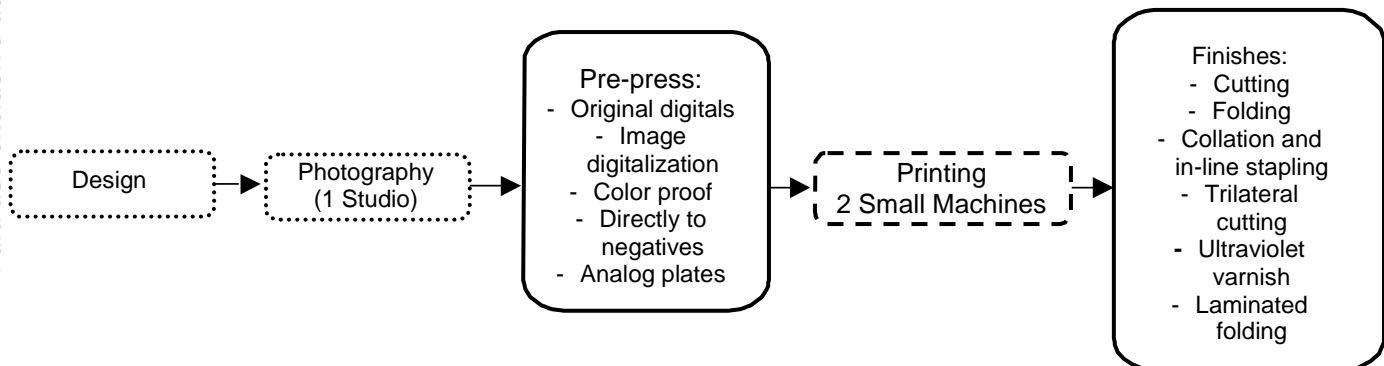
**Integration Processes**

**PROCESS INTEGRATION BY STAGES**  
**A Typical Printing House 1991-1994**



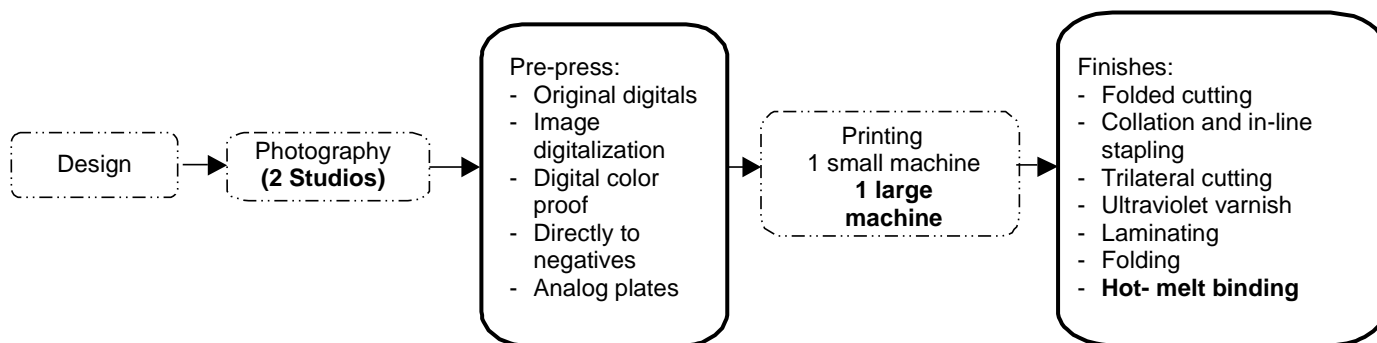
**EXHIBIT 1b**  
**COLOREANDO S.A. DE C.V. (A)**

**1992-1996**



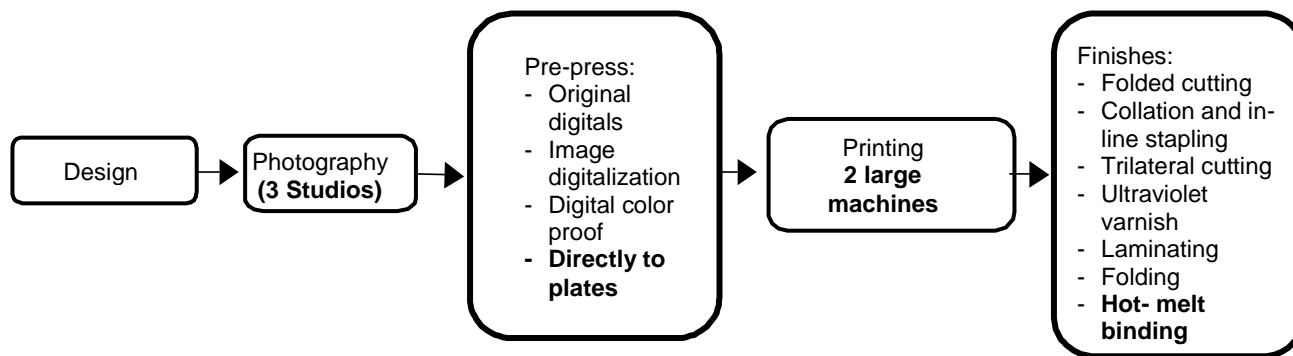
**EXHIBIT 1c**  
**COLOREANDO S.A. DE C.V. (A)**

**1997-1999**



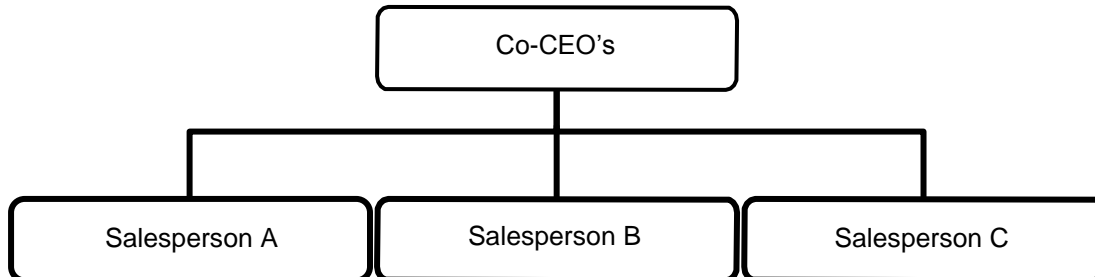
**EXHIBIT 1d**  
**COLOREANDO S.A. DE C.V. (A)**

**1999-2000**



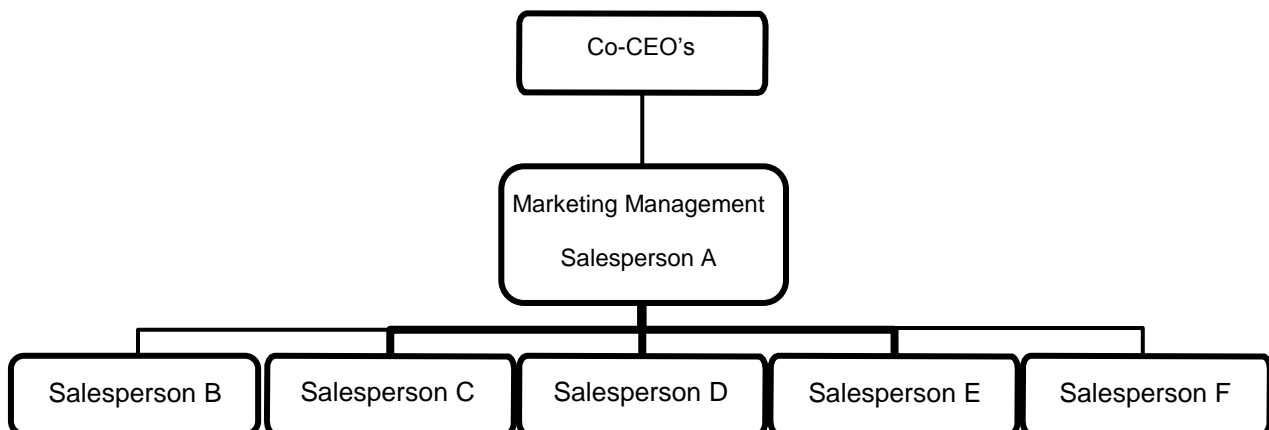
**EXHIBIT 2a**  
COLOREANDO S.A. DE C.V. (A)

**Marketing Department Organization Chart (1994-1996)**



**EXHIBIT 2b**  
COLOREANDO S.A. DE C.V. (A)

**Marketing Department Organization Chart (1996-1998)**



**EXHIBIT 2c**  
COLOREANDO S.A. DE C.V. (A)

**Marketing Department Organization Chart (1999-2000)**

