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Compagnie du Froid, S.A.

Jacques Trumen, CEO and major shareholder of Compagnie du Froid, S.A., was reviewing the performance of the three regions of the business: France, Italy, and Spain. Evaluating the performance of the regional vice-presidents was not a task that he enjoyed. Jacques had traditionally given each regional manager the same bonus: 2% of corporate profits. Jacques believed that this system avoided arbitrary evaluation criteria and encouraged open and fruitful communication among the regions about new ways of doing business.

The results in 2009 challenged the fairness of this evaluation system. The performance of the Spanish region had been extremely poor and had driven the company's overall profits to their lowest level in 10 years. Jacques thought that it was unfair to have the French and Italian managers pay for the problems of somebody else. But he was not sure how much Andres Molas, the manager of the Spanish division, was to blame for Spain's poor results.

Compagnie du Froid, S.A.

Founded in 1985 by Jacques Trumen's father, Compagnie du Froid, S.A. had grown steadily over the years to be a major competitor in the summer ice cream business. It had a dominant position in the coastal tourist areas from Perpignan to Nice and Monaco, the region where it was founded. In 2007, Jacques took over the business and re-directed the company into an aggressive growth strategy. By 2009, the company was a market leader in the eastern part of France, the northeastern coast of Spain, and northern Italy. Jacques kept a watchful eye on the efforts of the three regional managers to expand the operations to other key tourist areas in their regions, but his attention was mainly devoted to the creation of a new business: a year-round ice cream operation based in Paris.

Jacques believed very much in decentralizing decision making as much as possible. Each region had its own manufacturing, marketing, distribution, and sales organization. Regional managers chose distinctive names for new products, the level and mix of advertising, and local suppliers. The central office maintained responsibility for the accounting and financial aspects of the business, development of new products in ice creams and "specialties" categories, and the sharing of experiences and learning across the regions.

Professor Robert Simons and Doctoral Student Antonio Dávila prepared this case with the assistance of Research Associate Kathryn Rosenberg. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

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Jacques exercised control of the regions through a profit planning system. The profit plan covered the upcoming fiscal year which began on January 1. In November and December, each region prepared and submitted their initial profit plan to the central office. Jacques used the profit plan to discuss and supervise the expansion strategy of each region and to make sure that enough cash would be generated to support the company's new corporate ventures. The final phase of the profit planning process was a top management meeting which brought together Jacques, the three regional vice-presidents, and the finance and technical officers to discuss new growth opportunities. A lot of time and face-to-face contact was devoted to the profit plan and, once approved, it was the guiding tool to monitor and evaluate performance.

During the summer months, each region generated a profit statement every two weeks that Jacques reviewed to detect major problems. In addition, Jacques spent a week in each region to "get a feel for the market." At the end of October, another top management meeting occurred to learn from the experiences over the past year and to schedule winter activities to prepare for the next season. In early December, Jacques handed bonus checks to the three regional managers.

Top line revenue goals for the upcoming year were established using past growth rates and the market expectations of Jacques and the regional managers. Exchanging knowledge and experiences was a key element in shaping the growth assumptions of the profit plan. For 2009, the expected volume growth was 9% for the French region, 10% for the Spanish region, and 12% for the Italian region.

Since 2005, when Compagnie du Froid introduced its first specialty product—sophisticated ice cream flavors made with prime quality ingredients, the strategy had been to emphasize these specialties that enjoyed higher margins and less intense competition. This strategy became operational through the profit plan: Jacques set ambitious goals for the percentage of sales volume coming from specialties for each of the regions.

Standard selling prices and manufacturing costs were based on last year's actuals adjusted for any expected contingencies. Efficiency standards assumed that manufacturing would improve its year-to-year performance based on learning and better equipment.

Finally, Jacques believed that the business should compensate shareholders—himself, his brothers and sisters, and top managers in the company—for the risk of tying up their capital in the business. Thus, he expected a reasonable return on shareholders' investment. His reference point was 18% return-on-investment before taxes.

Exhibit 1 illustrates the standards used to design the profit plan for one of the three regions.

France

Jean Pinoux was the manager of the French region. He was promoted to this position in 2007 when Pierre Giroux, the previous manager, took over the lagging Italian operation. Jean had started as a sales representative, then advanced to be responsible for production, and finally became division manager.

Jacques was pleased with Jean's performance (see **Exhibit 2**). His profits were above budget, and sales had increased almost 20% over the previous year. Jean had invested a lot of his time in managing the expansion into the west coast of France, negotiating with new vendors and suppliers, and arranging distribution of the product. If all this effort had paid off in 2009, the profits would have been even higher, but Jacques knew that they would have to wait several years to get the full benefits from this investment.

The performance in the traditional regions of the French market had been a bit disappointing. Market share had slipped from 20% in 2007 to 18% in 2009. Jean Pinoux argued that his frequent trips to the west coast had negatively affected his relationships with distributors in the east coast.

The French region had bought new machines two years ago. While there had been some start-up problems, the machines ran smoothly during 2009 thanks to Jean's manufacturing expertise. The manufacturing operation was staffed with a core group of employees which supervised production and maintained the machines. Most of the workforce was people hired on an hourly basis.

Jean had found a new source of revenue from a personal friend who operated a well-known restaurant in Camargue. Over the summer of 2009, Jean's friend had decided to package his meals and distribute them through supermarkets and food stores in the region. He needed refrigerated trucks to deliver his products and Jean agreed to distribute them for a fee. Most of the retail outlets were already visited by Compagnie du Froid's delivery trucks and the incremental cost to the company to provide this service was very low. Jean saw this business opportunity as a simple way to increase revenue. By the end of the summer, he had agreements with two other regional food producers to deliver their products beginning in summer 2010. He planned to work over the winter season on getting more of these deals that were easy and very profitable.

Jacques was surprised by Jean's initiative, but acknowledged that there was a profit potential in the distribution business. He was concerned, however, that distribution was outside Compagnie du Froid's core business, and he felt unsure whether to follow this new opportunity (Compagnie du Froid's mission is reproduced in **Exhibit 7**).

Italy

Pierre Giroux was the manager for the Italian region. He had been in top management positions with Compagnie du Froid for the last 10 years. Previously he had run the French region, but Jacques asked him to take care of the Italian operation because it was not performing adequately. Jacques knew Pierre very well. He was an excellent manager with a very clear sense of the market. Although running the smallest region in the company, Pierre had been the main force in attaining a leadership position in the French market and was a close partner in Jacques' new ventures.

Pierre's performance as manager of the Italian operation had been excellent. He had attained his sales goals and expanded the distribution of the company's products into most of the western Italian coast.

In the manufacturing side, he had suffered from higher wages and lower efficiency than expected. The machines used in Italy had been moved from France when the new equipment was installed in France. The old machines were partly the reason for the lower efficiency, but this expectation had already been incorporated into the profit plan.

Exhibit 3 shows the performance of the Italian division in 2009.

Spain

Andres Molas was the manager for the Spanish region. He had been in charge of the Spanish operation since it started in 1995. Andres was the only non-French top manager. His performance had been outstanding until 2009. He had grown the division from scratch and he was well-respected for his innovative ideas. For example, last year he had developed a vending machine to sell specialties. The

idea had been so successful that France and Italy were planning to introduce it in 2010. Andres was the most successful manager in introducing new products to the market and the other managers followed some of his marketing ideas.

Unfortunately, 2009 had been problematic for several reasons. (**Exhibit 4** shows the performance of the Spanish region.) New machines, similar to the ones purchased in France, were bought early in the year to increase efficiency, but they did not perform adequately until late August. Technicians from the supplier had to spend several weeks adjusting the machines. Because of these problems, Andres had run out of capacity several times during the year and he had been forced to import product from the French division.

This was the first time that Compagnie du Froid had transferred sales between regions and Jacques had decided to set the transfer price at full cost plus a 5% profit for the manufacturer (see **Exhibit 5**). There was some argument about the policy. Andres was not happy about it because he said that it made his division look bad, but he accepted it as a temporary solution. In addition, the Spanish division had been forced to absorb the expenses of having people travel to France to help fit Spanish containers and packaging to the French production line.

In addition, the market had been very tough that year. Unseasonably cold temperatures had driven tourism down (**Exhibit 6** shows the history of sales and temperature for the various regions). Over time, Jacques had developed a rule of thumb that a 1°C deviation from the mean summer temperature resulted in a 3% change in volume growth. The 2009 summer temperatures in the coastal zones of Spain had been 1.7°C below average; thus Jacques' rule of thumb predicted volume growth to be only 4.9% rather than the planned 10%. The reaction of a large competitor to lower sales volume had been to lower prices to stimulate demand. Andres had followed with a price cut. Even with total market sales down, Andres decided to keep the level of advertising up to build market share.

The Bottom Line?

When Jacques finished reviewing all the information, he sat back and began to enjoy an ice cream. France and Italy had performed well, but Spain's performance had been dismal. Yet, he was unsure how each manager had performed given the circumstances. What did the differences between the profit plan and the actual performance really mean?

Jacques wondered if changes in company policy might be needed. What would happen if he suddenly changed his traditional evaluation system and gave different bonuses to the regional managers? Could he come up with a compensation formula that would be fair? This would be the perfect solution: an evaluation scheme that reflected each manager's performance without the discussions and tensions linked to subjective evaluation. But he was unsure if performance should be linked to (1) the profit plan, (2) strategic goals such as revenue growth, or (3) some overall measure of economic results. Perhaps he should just stay with his traditional method and give each manager a fixed percent of corporate profit.

There were also issues to be resolved about transfer prices. Some of the managers—Andres in particular—had been unhappy with his temporary solution. And Jacques still had not decided what he should say to Jean about his new distribution arrangements.

Exhibit 1 Examples of Standards for the 2009 Profit Plan (Spanish Region)

Standards	Spain
Percentage of volume from specialties	10%
Selling prices (in Euros)	
Ice-cream (per litre)	4.42
Specialties (per litre)	8.13
Manufacturing costs (in Euros)	
Dairy ice-cream (per litre)	2.61
Other ingredients ice-cream (sugar, flavor, etc. per 100 grams)	1.51
Other ingredients specialties (sugar, flavor, etc. per 100 grams)	2.12
Labor (wage per hour)	8.13
Labor hours ice-cream (litres per hour)	107.20
Labor hours specialties (litres per hour)	11.04
Volume	
Dairy ingredients—ice-cream (% of volume)	72%
Other ingredients—ice cream (grams per litre)	48
Dairy ingredients—specialties (% of volume)	93%
Other ingredients—specialties (grams per litre)	73

Exhibit 2 French Region, 2009 Results

	Profit Plan		Actual		Variance	
	Volume (<i>'000</i>)	Euros (<i>'000</i>)	Volume (<i>'000</i>)	Euros (<i>'000</i>)		
Sales Data						
Sales ice-cream (volume in litres)	4,010	17,879	4,618	20,005	2,126	F
Sales specialties (litres)	445	3,661	405	3,377	(284)	U
Revenue from distribution	-	-	-	79	79	F
Total Sales	4,455	21,540	5,023	23,461	1,921	F
Cost of Goods Sold						
Cost ice-cream						
Dairy ingredients (litres)	2,887	7,893	3,317	9,142	(1,249)	U
Other ingredients (100 gr.)	1,844	2,841	2,047	3,186	(345)	U
Labor (hours)	38.29	371	43.56	438	(67)	U
Cost specialties						
Dairy ingredients (litres)	410	1,121	368	1,015	106	F
Other ingredients (100 gr.)	316	693	298	655	38	F
Labor (hours)	40.03	388	36.02	362	26	F
Contribution margin		8,233		8,663	430	F
Other Costs						
Supervision, energy, maintenance, ...		2,206		2,324	(118)	U
Depreciation		467		467	-	
Operating margin		5,560		5,872	312	F
Selling and Administrative Expenses						
Delivery expenses		861		908	(47)	U
Depreciation of trucks		507		510	(3)	U
Selling expenses		1,078		1,139	(61)	U
Advertising		1,141		1,070	71	F
Administrative salaries and expenses		788		810	(22)	U
Allocated central office expenses		158		193	(35)	U
Profits before Interest and Taxes		1,027		1,242	215	F
Identifiable Assets						
Cash (average)		94		141	(47)	
Accounts Receivable (average)		580		634	(54)	
Plant and equipment (net of depreciation € 2,322)		4,713		4,726	(13)	
Total identifiable assets		5,387		5,501	(114)	
Conditions for tourism						
Average summer temperature		29.8 °C		29.2° C		

Exhibit 3 Italian Region, 2009 Results

	Profit Plan		Actual		Variance	
	Volume (<i>'000</i>)	Euros (<i>'000</i>)	Volume (<i>'000</i>)	Euros (<i>'000</i>)		
Sales Data						
Sales ice-cream (volume in litres)	2,453	10,967	2,480	11,106	139	F
Sales specialties (litres)	<u>272</u>	<u>2,232</u>	<u>276</u>	<u>2,253</u>	<u>21</u>	F
Total Sales	2,725	13,199	2,756	13,359	160	F
Cost of Goods Sold						
Cost ice-cream						
Dairy ingredients (litres)	1,864	4,963	1,895	4,986	(23)	U
Other ingredients (100 gr.)	1,275	1,885	1,296	1,932	(47)	U
Labor (hours)	33.10	300	36.03	328	(28)	U
Cost specialties						
Dairy ingredients (litres)	259	689	257	676	13	F
Other ingredients (100 gr.)	196	425	197	430	(5)	U
Labor (hours)	24.24	220	23.29	212	8	F
Contribution margin		4,717		4,795	78	F
Other Costs						
Supervision, energy, maintenance, ...		1,142		1,135	7	F
Depreciation		<u>109</u>		<u>109</u>	-	
Operating margin		3,466		3,551	85	F
Selling and Administrative Expenses						
Delivery expenses		329		315	14	F
Depreciation of trucks		198		198	-	U
Selling expenses		314		344	(30)	U
Advertising		1,328		1,288	40	F
Administrative salaries and expenses		558		574	(16)	U
Rent		122		122	-	
Allocated central office expenses		<u>158</u>		<u>193</u>	<u>(35)</u>	U
Profits before Interest and Taxes		<u>459</u>		<u>517</u>	<u>58</u>	F
Identifiable Assets						
Cash (average)		94		108	(14)	
Accounts Receivable (average)		377		357	20	
Plant and equipment (net of depreciation € 3,200)		<u>2,763</u>		<u>2,764</u>	<u>(1)</u>	
Total identifiable assets		<u>3,234</u>		<u>3,229</u>	<u>5</u>	
Conditions for tourism						
Average summer temperature		29.7° C		29.8° C		

Exhibit 4 Spanish Region, 2009 Results

	Profit Plan		Actual		Variance	
	Volume (<i>'000</i>)	Euros (<i>'000</i>)	Volume (<i>'000</i>)	Euros (<i>'000</i>)		
Sales Data						
Sales ice-cream (volume in litres)	3,685	16,294	3,575	15,507	(787)	U
Sales specialties (litres)	<u>409</u>	<u>3,330</u>	<u>400</u>	<u>3,251</u>	<u>(79)</u>	U
Total Sales	4,094	19,624	3,975	18,758	(866)	U
Cost of Goods Sold						
Cost ice-cream						
Dairy ingredients (litres)	2,653	6,923	2,175	5,607	1,316	F
Other ingredients (100 gr.)	1,769	2,670	1,450	2,202	468	F
Labor (hours)	34.37	279	29.21	238	41	F
Cost specialties						
Dairy ingredients (litres)	381	994	362	933	61	F
Other ingredients (100 gr.)	299	633	275	571	62	F
Labor (hours)	<u>37.09</u>	<u>301</u>	<u>34.73</u>	<u>283</u>	18	F
Contribution margin		7,824		8,924	1,100	F
Other Costs						
Supervision, energy, maintenance, ...		2,145		2,166	(21)	U
Depreciation		391		391	-	
Transfer from France		-		<u>2,126</u>	<u>(2,126)</u>	U
Operating margin		5,288		4,241	(1,047)	U
Selling and Administrative Expenses						
Delivery expenses		736		758	(22)	U
Depreciation of trucks		413		424	(11)	U
Subcontracted transportation		-		77	(77)	U
Selling expenses		827		786	41	F
Advertising		1,406		1,408	(2)	U
Administrative salaries and expenses		620		644	(24)	U
Rent		100		100	-	
Allocated central office expenses		<u>158</u>		<u>193</u>	<u>(35)</u>	U
Profits before Interest and Taxes		<u>1,028</u>		<u>(149)</u>	<u>(1,177)</u>	U
Identifiable Assets						
Cash (average)		94		98	(4)	
Accounts Receivable (average)		423		266	156	
Plant and equipment (net of depreciation €1,669)		<u>4,764</u>		<u>4,837</u>	(73)	
Total identifiable assets		<u>5,281</u>		<u>5,201</u>	<u>80</u>	
Conditions for tourism						
Average summer temperature		30.2° C		28.5° C		

Exhibit 5 2009 Ice cream Transfers between France and Spain

	Ice-cream		Total (in '000 Euros)
	Cost of ingredients	Cost per litre	
Volume transferred (in '000 litres)			603
Actual Costs (in Euros)			
Dairy Ingredients	2.76	1.98	1,194
Other Ingredients	1.56	0.69	416
Labor	0.09	0.09	57
Allocated Fixed Costs (in Euros)			
Other costs		0.46	279
Depreciation		0.09	56
S&A expenses		0.04	23
5% profit margin		0.17	101
Total transfer price		3.53	2,126

Exhibit 6 Historical Data – Temperature and Sales Volume

France			
Year	Temperature (degrees Celsius)	Sales Volume (’000 litres)	Volume Growth
1995	27.7	1,344	
1996	29.2	1,435	6.7%
1997	28.4	1,484	3.4%
1998	30.9	1,714	15.5%
1999	32.9	2,031	18.5%
2000	27.3	1,984	-2.3%
2001	30.0	2,208	11.3%
2002	30.5	2,489	12.7%
2003	30.8	2,761	10.9%
2004	30.0	2,998	8.6%
2005	29.7	3,216	7.3%
2006	30.3	3,445	7.1%
2007	29.6	3,797	10.2%
2008	29.4	4,087	7.6%
2009 (budget)		4,455	9.0%
Average	29.8 °C		9.1%

Spain			
Year	Temperature (degrees Celsius)	Sales Volume (’000 litres)	Volume Growth
1995	30.8	1,069	
1996	31.2	1,272	18.9%
1997	29.0	1,402	10.2%
1998	31.6	1,685	20.2%
1999	29.8	1,852	9.9%
2000	28.3	2,006	8.3%
2001	28.0	1,964	-2.1%
2002	27.5	2,033	3.5%
2003	29.9	2,231	9.8%
2004	30.4	2,481	11.2%
2005	31.8	2,684	8.2%
2006	32.4	3,036	13.1%
2007	30.4	3,346	10.2%
2008	31.0	3,722	11.3%
2009 (budget)		4,094	10.0%
Average	30.2 °C		10.2%

Exhibit 6 Historical Data – Temperature and Sales Volume (Continued)

Year	Italy		
	Temperature (degrees Celsius)	Sales Volume (’000 litres)	Volume Growth
1999	32.2	892	
2000	30.4	1,036	16.1%
2001	28.6	1,143	10.3%
2002	31.8	1,434	25.6%
2003	28.1	1,508	5.1%
2004	28.2	1,639	8.7%
2005	29.0	1,771	8.0%
2006	28.3	1,872	5.7%
2007	30.1	2,090	11.7%
2008	30.0	2,433	16.4%
2009 (budget)		2,725	12.0%
Average	29.7 °C		12.0%

Exhibit 7 Compagnie du Froid S.A. Mission Statement

Compagnie du Froid, S.A. exists to offer customers the best in iced summer refreshments. We work as a team to produce and market only premium quality products that are known for innovation, quality, and value. In everything we do, we strive to delight our customers and offer an experience that reflects summer fun and relaxation.