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## Proceedings Editor's Letter

Welcome to the *Proceedings* of the 34th Annual Conference of the Small Business Institute®. Included in the *Proceedings* this year are twenty-eight competitive papers, four workshops, and five best practices.

There are many to thank for their contribution to a successful review process and first class *Proceedings*. First, I would like to thank the authors who submitted their outstanding work for the 2010 conference. These works are both of high quality and diverse in topic, and I think that you will find it worthwhile reading. Secondly, I would like to thank the dedicated track chairs and reviewers who worked diligently to complete their reviews in a professional and timely manner. The following individuals served as track chairs and deserve much of the credit for a smooth review process: Stephanie Bardwell, Joe Bell, Shawn Carraher, Peggy Chaudhry, Lynn Hoffman, Bill McDowell, Todd Mick, Terry Paridon, Jeff Shields, Harriet Stephenson, Patrick Walker and Dianne Welsh. I would also like to thank Ms. Kim Watkins from East Carolina University for her invaluable technical assistance in producing the *Proceedings* CD.

The 2010 National Small Business Institute® Conference is the result of hard work from numerous individuals, and is the culmination of a successful year under the leadership of Ron Cook. Our organization has always been noted for its exceptional collegiality and willingness to work together to promote the SBI brand.

Best wishes for a great 2010 conference!

Respectfully,
Michael Harris
Proceedings Editor

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# BLACK-OWNED AUTOMOBILE DEALERSHIPS AND THE CURRENT ECONOMIC RECESSION

Matthew Sonfield, Hofstra University

## Abstract

Black-owned automobile dealerships in the United States have been disproportionately impacted by the current economic recession. This paper presents an analysis of this significant impact and its implications. A "Historical Background" section examines the rise of black-owned auto dealers since the 1970s, largely due to manufacturers' formal programs to foster the establishment and growth of such dealers. A "Current Situation" section delineates the present economy's impact upon these dealers, and the reasons for this phenomenon. While most of these dealers are relatively powerless to overcome this impact, a "Strategic Responses" section gives examples of how some black auto dealers, with unusual financial strength and strategic insight, have been able to take advantage of certain opportunities presented by this economic situation, providing lessons to all small businesses. And while the story is far from over at this point, a few "Conclusions" are presented.

## Introduction

The current economic crisis has had a major impact on large and small companies throughout the world. The Gross Domestic Product in the United States has declined in each of the past three quarters, and expectations for the near-term future are not very positive (See Table 1). Especially hard hit by this crisis is the automobile industry, both American and foreign manufacturers and the wide network of other businesses that supply this industry and sell its products. This paper focuses on the impact of this crisis one specific segment of the automobile industry: black-owned automobile dealers.

Table 1. Gross Real Domestic Product – United States

| Quarter | Change |
|---|---|
| 2009 Q1 | -6.14% |
| 2008 Q4 | -6.34% |
| 2008 Q3 | -0.51% |
| 2008 Q2 | +2.83% |
| 2008 Q1 | +0.87% |
| 2007 Q4 | -0.17% |
| 2007 Q3 | +4.76% |
| 2007 Q2 | +4.79% |
| 2007 Q1 | +0.05% |

Source: U.S. Bureau Economic Analysis, 2009

## Historical Background

Over the past four decades, the number of black-owned automobile dealerships in the United States has risen from an insignificant number to one of significance. This is the result of both demographic changes and efforts made by the American automobile manufacturers (and subsequently foreign automobile manufacturers) to increase the number of minority-owned dealerships. As a highly visible component of the U.S. economy and under social, ethical and political pressures from various sources, in the 1970s and 1980s automobile manufacturers

established formal programs to increase the number of their minority-owned franchises. At the same time, as whites moved out of urban areas, white auto dealers abandoned these locations for new suburban locations and African American and other minority-owned dealers moved in to fill the void (Sonfield, 2007).

Because of the precarious nature of minority-owned businesses in this country, survival rates for these black-owned automobile dealers have been lower than for their white-owned counterparts. It is the on-going efforts on the part of the American and foreign automobile manufacturers to foster new minority franchisees over the decades that has kept the number of black-owned auto dealers relatively constant in the last twenty years.

The history of the industry segment can be best documented by looking at the magazine *Black Enterprise*'s annual listings of black-owned automobile dealerships as a segment of the one hundred largest black-owned companies in all industries (Table 2):

Table 2. *Black Enterprise* Top100 Listings by Industry through 2004 – All Industries

| | 1974 | 1979 | 1984 | 1989 | 1994 | 1999 | 2004 |
|---|---|---|---|---|---|---|---|
| Auto Dealerships | 24 | 32 | 44 | 55 | 50 | 48 | 41 |
| (% of total of top 100 companies) | 18% | 24% | 32% | 46% | 50% | 44% | 34% |

Source: *Black Enterprise*, June issue for each year.

Thus it can be seen that, within the total one-hundred largest black-owned businesses in the United States, the number of automobile dealerships reached a high of 55 in the 1989 listing (reporting on 1988 data). Although the number of companies had dropped five years later in the 1994 listing, the percentage of total *Black Enterprise 100* sales volume had continued to rise, to 55%.

In the past decade, the number of minority-owned automobile dealers (primarily black and Latino) has slowly declined. At the peak, about 2002-2003, there were about 2000 minority dealers in the US. At the start of the current economic downturn, that number had declined to about 1200 (NAMAD, 2009). More specifically, General Motors had 100 black-owned dealers in 1990; this number declined to about 40 in 2008 (Freeman, 2009).

## Current Situation

The current economic crisis has hit minority dealers especially hard, generally with more force than to white-owned automobile dealers (Kellogg, 2009). Many factors account for this disproportional impact. First, black-owned automobile dealerships tend to be more recently established and smaller than their white-owned counterparts. Thus they have always been more economically weak, and more susceptible to an economic downturn.

Second, these dealerships are more likely to be located in urban and inner-city settings. These are areas where the poor economy and increased unemployment are having a greater shock. Also, urban and downtown locations tend to be smaller and more cramped than the spacious suburban auto malls that are now popular. Urban franchises typically draw fewer shoppers and carry less inventory for customers to choose among. These factors tend to limit sales and make dealerships more vulnerable to sales declines

A third factor is that minority auto dealerships are disproportionately American-brand oriented. This is due to the fact that the American automobile manufacturers, under domestic pressures to do so, implemented efforts to foster the establishment of black-owned dealerships many years before foreign auto manufacturers initiated similar efforts. Since the current economic downturn has especially impacted American car sales, in particular General Motors and Chrysler, having gone through bankruptcy, black-owned dealers have been especially hard hit (CMDA, 2009; GMMDA, 2009)..

A fourth factor impacting black-owned automobile dealers is that these dealers tend to carry fewer brands of vehicles. For example, fewer black-owned Chrysler dealers have been converted into the company's "Genesis" format that puts all three of its brands (Chrysler, Dodge and Jeep) under one roof. Yet the majority of all Chrysler dealerships have a full three-brand format. Genesis dealer locations are usually more profitable because they sell and service more vehicles than single-brand dealerships. Chrysler plans to emphasize Genesis dealerships under its reorganization.

Similarly, black-owned General Motors dealerships are less likely to sell multiple GM brands. Furthermore, about 58% of the GM stores run by minority owners sell Pontiacs, Saturns, Saabs or Hummers - all brands the company plans to phase out or sell.
The most recent *Black Enterprise* data strongly confirms the precarious situation in which black-owned auto dealers find themselves. Although the *Black Enterprise* top 100 listings were started in the early 1970s as a single listing of the largest black-owned businesses (as defined by having more than 50% black ownership), by 1988 the importance of black-owned automobile dealerships had reached a level where two separate listings of the 100 largest black-owned companies were compiled – one for industrial and service companies and another solely for automobile dealerships. In 2009 (reporting 2008 data), for the first time since 1988, the performances of black-owned auto dealers was so weak that only 75 dealers were listed, and an "auto dealer of the year" was not named, as previously done each year. Extending Table 2 to include this most recent data, we obtain Table 3.

Table 3. *Black Enterprise* Top100 Listings by Industry through 2009 – All Industries

| | 1974 | 1979 | 1984 | 1989 | 1994 | 1999 | 2004 | 2009 |
|---|---|---|---|---|---|---|---|---|
| Auto Dealerships | 24 | 32 | 44 | 55 | 50 | 48 | 41 | 26 |
| (% of total of top 100 companies) | 18% | 24% | 32% | 46% | 50% | 44% | 34% | 24% |

Source: *Black Enterprise*, June issue for each year.

Another way to illustrate the sharp decline of black-owned auto dealerships in the past several years is by calculating total sales volume of the top 26 dealers (using the base number of 26 from the 2009 data in Table 3).

Table 4. *Black Enterprise* Top 26 Auto Dealers

| | 2007 | 2008 | 2009 |
|---|---|---|---|
| Total Sales Volume | $6,361.0 million | $5,642.1 million | $4,593.3 million |
| Percent Change | | -11.5% | -18.6% |

Source: *Black Enterprise*, June issue for each year. Data reconfigured.

Although not the focus of this paper, it should be noted that this sharp decline in the fortunes of the world-wide automobile industry (and especially the American industry) has impacted other types of black-owned businesses as well. In the *Black Enterprise* Top 100 industrial/service listings, at least 15% of the companies are direct suppliers to the auto industry, and are therefore affected similarly to automobile dealerships (Graves, 2009).

And certainly the future for the auto industry and for black-owned automobile dealers and suppliers appears bleak. As they entered bankruptcy, both Chrysler and General Motors announced major cuts in the number of their dealers. Their huge dealer networks were established when the American auto manufacturers enjoyed a 90% market share. Although exact number will not be known for some time, it is estimated that about 2600 of GM's 6200 dealers will be eliminated, and Chrysler may cut 1000 of its 3100 dealerships. Resulting job losses are estimated at 200,000. Without going through legal bankruptcy, Ford may be more restricted in cutting its dealerships, but certainly there will be cuts there too (Becker, 2009; Kiley, 2009).

Black and other minority dealers are expected to take a disproportionate hit as dealerships are eliminated. This is primarily because these dealers tend to be newer and smaller, and therefore less important to the auto manufacturers. While it may be several months before the exact numbers are known, some estimates are available. Prior to the current crisis, Chrysler had 47 black dealers (44 men and 3 women) and it is expected that this will be reduced 37 (35 men and 2 women). Estimates for GM are not yet available (Fortson, 2009).

Current estimates are that there will be no improvements in the demand for new automobiles in the second half of 2009 or in 2010. As far out as 2014, auto sales are expected to be sluggish, with numbers well below the peaks that were reached early in this current decade (Maynard, 2009).

## Strategic Responses

Some astute and proactive black automobile dealers are responding to this situation with creative and aggressive strategies. Several black dealers, especially those high in the listings with several auto brand outlets, are shedding their lower-priced makes and focusing on luxury makes only. For example, the number two dealer in the 2009 listing, Tony March of March Automotive Group with headquarters in Florida and dealerships in several states, is restructuring his business to become smaller and leaner. Mr. March is divesting three GM dealerships in Connecticut but retaining and focusing on his more profitable Infinity and Jaguar dealerships. Similarly, S. Woods Enterprises of Florida sold its Toyota dealership to focus on its Lexus outlet.

Sometimes these black dealers, primarily those in a strong financial position, are taking the opportunity to acquire sales franchises from financially weak dealers who have potentially strong brand outlets. Thus Steve Jackson in Dallas sold his Buick-Pontiac-GMC dealership but then opened a new Toyota franchise. These and other examples indicate that the current economy offers selected investment and potential growth opportunities to those dealers with both the financial resources and the strategic insight (Hughes, 2009).

## Conclusions

Obviously, this is a situation in flux. The story is not over and the dust has not settled. As of the summer of 2009, it is far too soon to reach conclusions regarding the future of black-owned automobile dealers in the United States (or all minority dealers). Perhaps a year from now, the full story can be told and full analyses can be developed. Until then, the only conclusions that can be reached are that 1) minority businesses in general, and black-owned automobile dealerships in particular, are disproportionately impacted by major economic downturns, and 2) it will take exceptional financial strength and strategic acumen for black-owned automobile dealers to do more than survive and to grow in the current economic situation.

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# ETHNIC MINORITY BUSINESSES AND TARGETED ASSISTANCE PROGRAMS IN THE U.S. AND THE U.K.: A COMPARISON AND IMPLICATIONS

Matthew Sonfield, Hofstra University

## Abstract

This paper focuses on the status of minority businesses in the United States and in the United Kingdom. In the United States, minority businesses have existed since colonial times, but in the United Kingdom (and throughout Europe) such businesses are largely a much more recent phenomenon, primarily the result of immigration in the past fifty years. Furthermore, in the United States a wide variety of targeted governmental and corporate programs have existed to foster and assist such businesses for many decades, and are established components of public policy. However, in the United Kingdom, such efforts are much less developed and often considered illegal under European Community regulations. This paper compares the two countries' current and likely future situations and recognizes that each situation offers some lessons to the other. Implications for the future in each country are presented.

## Introduction

Minority-owned businesses have existed in the United States since the 18th century, when free blacks and slaves engaged in a variety of small business endeavors, with both black and white customers (Walker, 1998, 1999). And since the late 1960's a wide variety of targeted governmental and corporate programs have existed to foster and assist such businesses (Kotlowski, 1998; Sonfield, 1997).

In the United Kingdom, the term "ethnic minority business" is most frequently used, as most minority-owned businesses are the result of immigration trends of the 20th century (Sonfield, 2003). Formal programs to assist such businesses have existed since the 1980s, but at a much lower and limited level, and with considerably less impact than in the United States (Ram and Smallbone, 2003a, 2003b).

This article compares both the status of minority businesses in each country and the nature and impact of targeted assistance programs, both governmental and otherwise, aimed at these businesses, in the United States and the United Kingdom. Analyses of the present and the future are presented, and lessons from each country for the other are presented.

## The Status of Minority Businesses and Assistance Programs

*United States*

The most recent U.S. federal data (for 2002) indicates that minorities owned approximately 18 percent of all American businesses, with higher growth rates than for white-owned businesses. Hispanics or Latinos now slightly outnumber blacks as minority business owners (Lowrey, 2007).

The development and support of minority businesses (initially mainly African-American-owned businesses) has been an objective of both the public and private sectors in the United States since the late 1960s. At that time, various federal, state and local government agencies initiated programs to further this objective, and subsequently many large American corporations began programs of their own. In the years since then, the focus of these programs has moved beyond just African-Americans and has been expanded to include other minority groups and women as well.

With the federal government taking the lead in this effort to develop such programs, the Office of Minority Business Enterprise was established in 1969, within the U.S. Department of Commerce. Its primary activities have involved the funding of a wide variety of local programs to provide one-on-one and group assistance to minority businesspersons. (This office is now called the Minority Business Development Agency.) At about the same time, the U.S. Small Business Administration began to tailor some of its programs specifically towards minority businesses - both direct and guaranteed loan programs and federal contract set-aside programs (Whistler and Wichmann. 1979; Sonfield. 1997; http://www.mbda.gov; http://www.sba.gov).

Also, in response to economic, ethical and political pressures, many large American corporations in the 1970s and 1980s initiated efforts to increase the number of minority and women-owned companies as suppliers of the goods and services they purchase. These corporations established their own programs within their procurement departments and joined with other big businesses to form minority procurement coordinating groups to act as clearinghouses between small minority firms and large corporations (Gupta, 1992; Fitzgerald, 1995; Morgan, 1995; Klimley, 1996; Sonfield, 1997).

In the 1990s, these public and private programs received both praise and criticism. Supporters argued that a variety of barriers do in fact exist for minority businesses, and that such programs were necessary to level the playing field and create opportunities for minority business creation and growth, and for job creation as well (Bates, 1997, 2001; Cavalluzzo and Cavalluzzo, 1998; Waldinger and Bailey, 1991). On the other hand, critics contended that these programs were a form of "reverse discrimination" and were inherently inappropriate and/or illegal (Freeman, 1994; Theodore, 1995). During this period, U.S. Supreme Court rulings set tough new legal standards for federal, state and local government minority assistance and set-aside programs, and both President Clinton and many state and local politicians issued executive orders to constrain or halt these programs. These new legal standards require a minority business seeking affirmative action assistance to document that it faces discrimination or other concrete barriers and furthermore that the business is fully able and willing to compete with current non-minority business suppliers (LaNoue, 1994). On the other hand, most *corporate* programs were not impacted by the court rulings and remained strong (Holmes, 1995, 1996; 'Many Minority,' 1995; Kirk et al., 1996; Sonfield 1997). In the current decade, corporate procurement programs targeted toward minority businesses remain active and effective, but governmental set-aside program continue to exist at only moderate levels, constrained by court rulings and a more conservative political climate with regard to the issue of preferential treatment.

*United Kingdom*

A significant rise in ethnic and immigrant business ownership has been seen in recent years in the U.K, and also throughout much of Europe, and a policy-related focus on such businesses has become especially important (Ram and Smallbone, 2003a). Recent studies have argued that past analyses of ethnic enterprises in the U.K have been too narrow, focusing largely on class, ethnicity and ethnic resources, and that broader macro-economic and regulatory issues should also be studied (Kloosterman and Rath, 2003). Furthermore, other studies have concluded that various U.K. policies and programs aimed at small enterprises in general may not be of value to, or may even have a negative impact upon, ethnic minority enterprises (Kontos, 2003).

In the U.K., terms such as 'ethnic business', 'black and minority ethnic business' (BME), and 'ethnic minority business' (EMB) are all used (the latter most frequently), and the five largest groups of 'historically ethnic minority entrepreneurs' are African-Caribbean, Indian, Pakistani, Bangladeshi and Chinese (Centre for Enterprise and Economic Development Research, 2001). Furthermore, EMB's have been the subject of growing interest in recent years, and the reasons for this are both economic and social. As such businesses constitute an increasing component of the national U.K. economy, they are thus important to economic growth. Also, as immigration into the U.K. has increased, strong and growing EMB's can contribute to reducing social exclusion and to raising living standards among disadvantaged minority immigrant groups (Ethnic Minority Business forum, 2005; http://europa.eu.int).

In the U.K., successful ethnic businesses are seen as a major component of urban regeneration (Ethnic Business, 2003), and concerns have been raised about a possible decline in the strength of South Asian businesses, a segment of the ethnic minority business community that has in the past been viewed as a positive example of immigrant progress (Ram and Smallbone, 2003a).

Still, in the U.K, there is very limited *specific* targeting of EMB's within small business assistance programs run by governmental and other agencies (Ram and Smallbone, 2003b). A recent U.K study found that the majority of government-sponsored business assistance and development efforts did not have any components or programs specifically targeting EMB's. Rather than having public and private-sector programs specifically targeted toward minorities as in the United States, the U.K response to the issue of minority business development is more often one of non-discrimination policies for small business assistance and public procurement. The U.K., as a member of the European Community, is bound by all EC legislation, and all governmental assistance programs, including procurement contracts and other forms of assistance providing benefits to individual businesses within the European Community are covered by EC treaty, no matter what their value, and this treaty includes a number of non-discriminatory principles (http://www.sbs.gov.uk). Basically, any services to businesses paid for with taxpayer money are restricted by EC and U.K. non-discriminatory rules and therefore may not be specifically targeted towards ethnic minority businesses or their owners, or to any other narrow group, and must be provided equally to all businesses and business owners. Very simply, American-style targeted minority assistance and set-aside programs are illegal in the U.K. (Cragg, 2009; Nicholls, 2009; Srinivasan, 2009).

However, the situation in the U.K is slowly changing. Some government agencies are beginning to implement proactive assistance programs specifically targeted towards ethnic minority businesses (in ways that do not violate EC rules). For example, some offices of 'Business Links' in England and 'Local Enterprise Companies' in Scotland are moving in this direction (Deakins et al., 2003).

Governments and their agencies are also beginning to recognize that some ethnic minority businesses are growing, and moving from labor-intensive to capital-intensive operations. Such growth and change requires external financing that smaller ethnic minority firms rarely needed, and some programs are being developed to assist these growing companies in their pursuit of such financing (Deakins et al., 2003, Ram et. al. 2003).

It is also beginning to be recognized that some existing governmental policies and legislation work *against* the development of ethnic minority businesses. For example, the British Shops Act limited the opening hours of retail shops. The unintended effect of this legislation was the entry of large-scale retail chains into local markets that had previously been protected niches for South Asian-owned stores. Those involved in ethnic minority business development policy now see a need to repeal such legislation (Barrett et al. 2001).

Also in the early stages of development are public and corporate procurement programs aimed specifically at ethnic minority businesses, similar to American government 'set-aside' procurement programs. Comparable programs may eventually develop in the private sector as well (Cormack and Niessen, 2002, McCrudden, 2004; Ram and Smallbone, 2003c; Shah and Ram, 2006).

Thus, many of the issues and challenges concerning ethnic minority businesses in the U.K., and resulting programs aimed at assisting and supporting such businesses, lag behind the American experience by several decades. Ethnic immigration and ethnic minority businesses in sizable numbers in the U.K. (and Europe) are a recent phenomenon in comparison to minority businesses in the USA.

## Implications and Conclusions

*United Kingdom*

The future directions of the U.S. and U.K. experiences indicate the value of cross-fertilization. While the United Kingdom is constrained by European Community non-discriminatory regulations which limit the opportunities for targeted policies and programs to specifically foster and assist ethnic minority businesses, it is clear that the U.K. need not "reinvent the wheel" and can learn from the American experience. Ethnic minority businesses constitute an important and growing component of the U.K. (and European) economy, and society will benefit by the growth and prosperity of such businesses. Working within, and possible modifying, EC regulations, both U.K. governmental entities and corporations should adapt those forms of assistance that have proven viable and of value in the United States to the national needs and situations of the U.K.

It can be argued that EC regulations do not preclude governmental affirmative action policies and efforts. Global Rights, an international human rights advocacy group, contends that "affirmative action is strongly endorsed by international law" and "Where there is proven inequality among people of different Races, international law – either implicitly or explicitly – requires states to engage in affirmative action"(Global Rights, 2005, p. 1).

In the future, as immigration issues continue to develop in the U.K. and throughout Europe, U.K. and EC regulations may adapt to this dynamic situation and be more flexible in circumscribing targeted governmental programs for ethnic minority businesses. If assistance programs specifically for EMB's, whether government-sponsored management consulting programs or set-aside government contracts, become more numerous, then the lessons learned over many decades in the United States could allow for a more smooth and effective implementation of future U.K. efforts. Similarly, more than thirty years of American corporate programs to foster minority business suppliers can provide guidance for large U.K. companies wishing to strengthen society and the economy through EMB growth.

In the U.K., the role of EMB's has too often been limited to "co-ethnic trading," with such businesses primarily serving their own ethnic markets, and thus limiting their growth potentials. To move beyond such constraints, EMB's must "break out" of their current markets and business models. Recent U.K. studies and laws have pointed in this direction. Cabinet Office and other governmental Task Force reports have urged the use of public procurement as a policy mechanism, and various governmental agencies have been charged with fostering enterprise among socially and economically excluded ethnic groups. Also legislation (such as the "Race Relations Act") now seems to support moderate levels of targeted assistance. In the private sector, large companies in the U.K., such as British Telecom, are just beginning to introduce formal "supplier diversity" programs to increase their purchasing from EMB's (Ram and Smallbone, 2003c). As all of these initiatives progress, the American experience can provide guidance and increase the chances for effectiveness.

*United States*

Conversely, while American targeted efforts and programs have been established and successful for many years, there are now lessons to be learned from the United Kingdom. Two factors are central to this point.

First, various American court rulings continue to constrain affirmative action policies and practices. As previously noted, two important U.S. Supreme Court rulings (*City of Richmond v. J.A. Crosson Co*. [1989] and *Adarand Constructors, Inc. v. Pena* [1995]) considerably constrained governmental set-aside programs. More recent court rulings, at various federal and state levels, continue in this direction.

Second, demographic trends in the United States indicate that "minority" may be a meaningless term a few decades from now. The nation's most populous states, California and Texas, already have "minorities" constituting a majority of the population. If these trends continue, in 2023 nonwhites will gain the national majority of Americans under the age of 18. And by the year 2042, they will make up more than half of the entire population (Douthat, 2009).

Clearly, in the future, targeted public and private efforts to foster and assist minority businesses in the United States may seem meaningless and/or inappropriate. Whatever programs that continue to exist will have to be totally free of "reverse discrimination." If non-discriminatory policies and programs to assist EMB's can be developed today and in the short run in the U.K, then these can serve as models for American policies and programs in the long run.

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# STUDENT BUSINESS PLAN COMPETITIONS: WHO REALLY DOES HAVE ACCESS?

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## Abstract

Student business plan competitions no longer resemble a classroom project, initiated at the start of a semester, often based upon a student's original thought, and hastily submitted to a competition, more likely than not, within driving distance of your school. Today, competitors and competitions have morphed into year-long strategic initiatives reliant upon high-technology, or even bioscience research projects sought by out zealous MBA team members. Today, institutions are driven by the peer, community, and donor recognition they garner should a student team win one or more of the many prestigious competitions available. So where does that leave average schools where resources are little or non-existent, curriculum changes or expansion are not available, students lack entrepreneurial experience, access to top flight advisory boards for teams is limited, and technologies are difficult to come by, or exceed team member capabilities? Are the days of the original classroom idea or the "startup" restaurant gone?

## Preface

Research by Bowers, Bowers and Ivan (2006), assessing "entrepreneurship centers measures of success" showed that 45% of respondents used "business plan competition awards" as a measure of success. Donor relations and endowments as a level of importance to the centers ranked at 58% and 49%, respectively. Four of the top seven responses to "measures of success" related directly to funding activities. In response to the qualitative section of the survey, the #1 priority for all centers was identified as funding. Ultimately, they found that seventy percent of centers participated in business plan competitions. The authors of that study acknowledged that they somewhat struggled with a correlation between resources and center success, but unequivocally asserted that "*adequate and sustainable* funding should be secured early in the development of the center." The authors also suggest that there were some limitations in their research. One of the areas that might have affected their outcomes was that center success may also be a function of the students' backgrounds and abilities. In other words, schools that attract the best students may well have better outcomes. The authors in closing point out that future research should be conducted on how a center's resources impact on center success and recognition.

From this research, it can be implied, either implicitly or explicitly, that funding plays a large role in the success of an entrepreneurship center. Another issue seemingly of great importance is the success or notoriety that a center is able to highlight with their donor base. The study implied that not only the raising of funds was important, but also, the retention of the donor base. With such a large number of business plan participants (70%) and a corresponding group indicating that success at a business plan competitions (45%) was an important measure of success, one might infer that a lack of success at business plan competitions, when judged against your peers, could be indicative of a less than successful entrepreneurship center or program.

## Introduction to Competitions

Business plan competitions first started in the early 1980's at the University of Texas. Two Texas MBA students wanted to have a business school activity that was as challenging and prestigious as the law school Moot Court competitions. The competition had its first trial run in 1984 with only Texas MBA students participating in their "Moot Corp." By 1989 they had gone national, competing against teams from Harvard, Wharton, Carnegie Mellon, Michigan, and Purdue. In 1990 the competition went international with the London Business School, Lyon Graduate School of Business from France, and Bond University from Australia joining the competition. Since then, the number of competitions has increased dramatically worldwide, many of them sponsored by leading venture capital firms. (Small Business Notes, 2009)

Student entrepreneurs like these competitions because they can develop and pitch their fledgling business ideas to real investors and get professional-grade feedback. They also stand to win cash prizes -- typically, ranging anywhere from $10,000 to $100,000 per competition -- plus coveted business services, such as accounting and marketing help. In 2005, Rice University began offering funding in the form of equity investments pooled together by a few venture capital investors. The 2008 equity investment amounted to $325,000 while the total prize package weighed in at a $685,000, up from $42,500 in 2004. The 2008 business plan competition, which took place during the first week of April, attracted 234 teams represented by 820 participants, from the U.S. and abroad, up from 120 teams or about 420 people in 2007. (Ransom, 2008)

## Building the Case for Competitions

Research shows that business plan competitions provide a significant opportunity to enhance entrepreneurial education [even] within tertiary institutions. Although business plan competitions are created to primarily encourage the creation of new enterprises, participants gain important and long-lasting benefits, such as entrepreneurial skill development, increased self-confidence, and risk-taking propensity, and access to mentors and networking opportunities. This “real world”, practical education is not only important in successful business start-ups; it is also in high demand from employers. (Russell et al., 2008)

Huffman and Quigley, (2002) state that competitions of this nature help promote entrepreneurship by providing an avenue for individuals with ideas and those involved with start-ups (e.g., business angels, venture capitalists, serial entrepreneurs and professionals, such as bankers, lawyers and accountants) can network to discover, develop, and exploit business ideas. Foo, et al. (2004) expanded on the prior thought by stating that business ideas are by themselves plentiful; and unless the team’s idea is positively evaluated, it might not be able to attract funding or obtain access to potential suppliers and customers. This becomes a very important later in the paper as we begin to look at who really has access to business plan competitions. Dodt, et al, (1999) found that potential business innovators remain in their universities, hospitals, and research institutions, and the engine of wealth creation is never ignited, but suggests that business plan competitions are the catalyst for bringing technology out of these institutions. They go on to state, that business plan competitions have four aims:

- To motivate people to come forward with their ideas
- To build their communication skill
- To attract venture capital
- To identify service providers

An important observation by Dodt, et al, (1999) is that for a business plan competitions to be effective they must attract a sufficient number of participants; ideally at least 100. To encourage involvement, the competition must be well promoted and its threshold for admission kept low, so that even those who have never written a plan can take part. They suggest that one of the reasons that a business plan competition is in place is to allow the development of skills even of those with minimal business knowledge, and to have their reasoning tested.

Student entrepreneurs involved in the contests learn lessons from the experience and feedback. If you closely monitor the circuit of contests, you'll no doubt see some of the same teams competing in two, three or even more of these contests, sometimes over two or more academic years. If practice does not make perfect, it at least irons out some of the kinks. In fact, many students say they learn more preparing for and participating in a business plan competition than during an entire MBA program. (Cannice, 2004)

## The Team

The Timmons model (1999) emphasizes the flexibility and dynamic balance of three primary elements; the team, the opportunity, and the resources from the entrepreneurial process. The model also points out that venture teams need to have creative problem solving capability in order to move on to the next stage when venture teams interact with opportunities. Wen and Chen (2007) state there are many extra little stimuli throughout the competition processes, which affect the interaction of teams towards the real world and real learning. And follows by saying, that the business plan competition process produces very real business situations, during which teams confront challenges which might be beyond their prior knowledge and experiences. Wen and Chen (2007) further observed that the key triggers for creativity come from looking for technology, writing business plans, and terminating the cooperation with the technology group. Except for the business plan, Wen and Chen (2007) contend the other two activities are unexpected and out of control. The main objective of the competition then, is to provide teams with disturbance to a certain extent, so that they can and will integrate their former knowledge and experience to respond to the environmental changes, which inspires creativity.

## Overview of the Donald W. Reynolds Governor's Cup Business Plan Competition (2002-2009)

With one of the largest cash prize pools in America, the Donald W. Reynolds Governor's Cup Business Plan competition ("Competition") encourages students attending any Arkansas 4 or 2 year college or university to act on their ideas and talents in order to produce tomorrow's businesses. Over its eight year history, 1,290 students representing 19 Arkansas colleges and universities have participated in the event since it began in 2001. The students and their faculty advisors have received over $903,000 in prize money. (Arkansas Economic Acceleration Foundation website, 2009)

In reviewing the business plan topics posted on the Competition website, at the graduate level, it becomes quickly apparent that to place in the competition requires a technology-based business. Nearly 100% of the graduate winners (first through third) since 2002 have had a significant technology component to their plans. Based upon the intricacies of the technologies (e.g., RFID, nanotechnology, biosciences, etc.) it can be assumed that most, if not all of the technologies, are beyond the scope of the technology development competencies of a typical MBA team. There also seems to be a growing emphasis on technology-based ventures at the undergraduate level with over 50% of the top three finishers having a significant technology component associated with their plan. (Arkansas Economic Acceleration Foundation website, 2009)

The Competition is dominated by a very limited number of schools. The University of Arkansas at Fayetteville ("UA") dominates at the graduate level while John Brown University (JBU"), Harding University ("HU"), and again, UA dominate at the undergraduate level. Over the past seven years UA has placed in the top three finishers at the graduate level 18 of 21 opportunities. At the undergraduate level, JBU placed eight teams, while HU and UA each placed five teams. This means, at the undergraduate level, three schools placed 18 of 21 teams. It should be noted that UA is the flagship institution in Arkansas while JBU and HU are both private institutions.

As an example of the prolific success of a UA team, this spring (2009), the Tears of Life, LLC team from UA won first place in the graduate competition receiving $20,000 and an additional $5,000 innovation award at the 2009 Arkansas Donald W. Reynolds Governor's Cup. The team went on to win $25,000 in the Donald W. Reynolds Tri-State Cup and $1,000 for graduate elevator pitch in Las Vegas; first runner-up and $5,000 and first place for best presentation in the Super Bowl of business plan competitions, the Global Moot Corp Competition at the University of Texas; first place and $10,000 and second place in trade show at University of Cincinnati Spirit of Enterprise MBA Business Plan Competition; first place and $20,000 at Tulane University Business Plan Competition. (Innovate Arkansas, 2009) And as Cannice (2004) noted earlier, this is an example of a team that has successfully entered and competed in a number of competitions over the course of a single semester.

So as teams continue to dominate what happens to the number of entrants? Here are the results of the competition submissions and University participation for the Donald W. Reynolds Governor's Cup Business Plan Competition from 2006 through 2008:

Table 1. Donald Reyonds Governor's Cup Business Plan Competition

| | 2006 | 2007 | 2008 |
|---|---|---|---|
| Actual plans entered | 61 | 58 | 37 |
| Number of Universities represented | 14 | 13 | 9 |

As you can see the number of plans entered has decreased, and of greater concern, the number of universities participating has also seen a downward trend. Some might argue that the process is self- selecting and the best competitors remain in the competition while the less competitive schools drop out. Others may contend that resource rich institutions have the wherewithal to dominate more middle of the road or tertiary institutions. This leads us to a discussion as to the impact of schools and their students not participating in competitions.

## Discussion

Worldwide $28.8 billion was invested in over 2550 venture capital backed deals in 2008 (en.wikipedia.org/wiki/Venture_capital). A 2009 report, sponsored by the Kauffman Foundation evaluated venture financing among companies on the Inc. 500 list of the fastest-growing private companies. Only 16 percent, of the roughly 900 unique companies on the list from 1997-2007, had venture capital backing. In other words, less than one-in-five of the fastest-growing and most successful companies in the US had venture capital investors. The report also noted that only a tiny percentage (less than 1 percent) of the estimated 600,000 new employer businesses created in the United States every year, obtain venture capital financing. (Kedrosky, 2009)

On a worldwide basis it is estimated that 50 million new firms are started each year. That is the equivalent of about 137,000 per day. (Mason, 2009) On a worldwide basis venture capital has less than a negligible influence on business financings. When focused upon the U.S. alone, which represents 33% of all venture capital Investment (en.wikipedia.org/wiki/Venture_capital), as we have seen, very few businesses are venture capital financed. Yet, why have these types of businesses begun to dominate business plan competitions? With the exception of but a handful of competitions, most favor ideas that are suitable for venture capital investment. The venture capital community has become the cornerstone of competition judging, and in doing so, they reward those deals that have the potential to be venture capital backed. (Sauer, 2003) That same Inc. Magazine (Sauer, 2003) went on to quote Jay Ebben, professor from the University of St. Thomas, who noted that "there is concern that they [competitions] have become more of an investment competition than a business plan competition".

It can be concluded from the data gathered from the Donald W. Reynolds Governor's Cup Business Plan Competition that technology-focused ventures (85%) dominate the competition at the graduate level. And again, they also represent a large portion of competitors at the undergraduate level. This suggests that if the plan does not have adequate upside venture capital investment potential, it is far less likely that the plan will be selected as a top three finisher. Therefore, it can be assumed that other well-written business plans have been submitted, but as Ebben in the Inc. Magazine article pointed out, these competitions have become more of an investment competition than a business plan competition.

Earlier in the paper, this author points out numerous advantages to student participation in business plan competitions. But if certain plans on their face are disadvantage at the outset, what is the lost learning opportunity for many students? From the earlier research the following observations seem to be supported.

Foo, et al. (2004) stated that unless the team's idea is positively evaluated, it might not be able to attract funding or obtain access to potential suppliers and customers. Foo, et al (2004) believe that students have a wonderful opportunity to gain exposure for their product or service not only for funding purposes, but also within their vertical market. In light of the data, the conclusion is that if competitions are becoming more selective based upon both quality of the business plan (which is a good criteria), and seemingly the "strength" of the underlying technology, fewer ventures whose focus is not upon obtaining venture capital types of investments, will be selected. So should fewer, "less sophisticated" plans be selected, then contrary to what Dodt, et al, (1999) suggest, business plan competitions *would not be a* place to allow the development of skills for those of minimal business knowledge, and to have [student] reasoning tested because they probably would not be selected to progress through the different phases of the competition. Competition entrants that do not proceed past the initial round, may receive feedback on the written plan, and in many instances at best, this review would be cursory. Here, the students would not benefit from the defense of the plan, explaining its assumptions, and expanding upon its particulars.

As Wen and Chen (2007) discussed, triggers of creativity come from looking for technology, writing business plans, and terminating the cooperation with the technology group. Termination of the cooperation with the technology group was identified as one of the components they

termed as being unexpected and out of control. If that is the case, a main objective of the competition is to provide teams with disturbance to a certain extent, so that they can and will integrate their former knowledge and experience to respond to the environmental changes, which inspires creativity. The termination of the cooperation with the technology group most often would occur where the team presents to the judges, separate and apart from the technology investigators (e.g., scientists, patent-holders, etc.). So again, though a plan maybe well constructed and the venture possesses a significant degree of viability, it will not be selected unless there is potential to attract venture capital investment.

Cancer treatments and nanotechnology-based business plans can fair well at competitions. But for teams assembled for the purpose of the competition, do the students have an adequate grasp of the technology and the depth of industry-specific knowledge for business launch, or is it only adequate for competition purposes? Does it then defeat the purpose, as Russell (2008) stated, that the primary purpose of competitions is to start businesses? In other words, the students can perform well for the purposes of the competition but the potential to commercialize the technology is not present. It would not support what Dodt et al, (1999) suggested in that competitions are the catalyst for bring technology out of the institution. Does today's competition environment actually work against broad commercialization?

And as observed by Cannice (2004), what you "will no doubt see some of the same teams competing in two, three or even more of these contests". A proliferation of well-resourced institutions travel the competition circuit making it more difficult for good ideas, lacking a venture capital focused, to get vetted through the competition process.

## Conclusion

Creating a business plan with all the aspects of fundraising and an ultimate exit or harvest event is both challenging and stimulating. This type of preparation provides for a comprehensive learning experience, as many students say they learn more preparing for and participating in a business plan competition than during an entire MBA program. (Cannice, 2004) Would creating a plan short of seeking venture capital be less of a learning experience? I am sure some would argue yes. But the focus of business plans competitions has shifted from a broadly available learning opportunity to a venture capital-specific competition.

No longer is the standard, if you win, but how many times do you win. It has a crowding out or chilling effect. Have we reached a point where the same 100 business plans go from competition to competition? Is it the best plan that wins or now do we have the best resourced schools that have the ability to continually vet their plans across a series of competitions, as the anticipated winners? So are schools that have limited resources, or one shot at a competition, less competitive? Do donors or administration really understand the impact of the flight of today's competitions? Are they less noteworthy? Are the days of the original classroom idea or the "startup" restaurant gone? And just maybe, as the numbers are beginning to point out, some universities just opt out.

## Unsolicited Commentary

It is our responsibility as university and college educators to push our students outside of the box and challenge them with situations and ideas that are foreign, and as Wen (2007) suggested, a

"disturbance". What sits before us in the classroom is the "top" 20%, plus or minus, of learners that our country has to offer. Not that those who choose not to attend college are less capable, but some have selected this path of education as their next challenge. We would be remiss to not offer opportunities to validate and challenge their thinking, reasoning, decisions and ultimately, their work product, and in this case, their business plans. But now to offer my students that outlet, I must encourage them to select a technology, rather than to think and solve a problem for themselves. It is with great despair that I read an extremely well-written and comprehensive business plan about, for example, an "average" pet product, designed and built by a graduate student, and then having to break the news that you have little or no chance of winning the competition because your idea lacks the ability to attract venture capital financing; it's not "sexy" enough. It does appear that the days of the original classroom idea and the startup restaurant are behind us.

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# A PROPOSED INVESTIGATION OF ENVIRONMENTAL SCANNING PRACTICES BY ENTREPRENEURS

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## Abstract

This paper reviews the literature on environmental scanning in new firms. We identify previous relationships between environmental scanning and success and determine any information gaps. Based on these findings, it provides a research design to address these gaps through the development of a questionnaire and hypotheses.

## Introduction and Research Objective

The overall goals of this research are to discover if entrepreneurs change their environmental scanning pattern after startup, and determine if there is a relationship between environmental scanning and success of the business. To accomplish this, we operationalize "success" and environmental scanning. Questions were developed to clarify the scanning activities of the entrepreneurs in pre-startup and post-startup phases**.** The objective is to better understand the information seeking behavior of entrepreneurs (scanning) and the relationship of that behavior to success.

What is environmental scanning? Environmental scanning is a type of information behavior defined as "how people need, seek, manage, give and use information in different contexts" (Savolainen, 2007, p. 112). Environmental scanning is the term given by business people to information seeking about the world in which a business exists. It was initially described by Francis Aguilar in his 1967 book, Scanning the Business Environment, as "the way in which top management gains relevant information about events occurring outside the company in order to guide the company's future course of action" (Aguilar, 1967, p. vii). Another thorough yet succinct definition comes from Kendra S. Albright in a 2004 article:

> *Environmental scanning is the internal communication of external information about issues that may potentially influence an organization's decision-making process. Environmental scanning focuses on the identification of emerging issues, situations, and potential pitfalls that may affect an organization's future* (p.40).

In his overview of this topic, Jorge Costa describes Fahey and King's division of environmental scanning into two perspectives, outside-in and inside-out. The "macro" or outside-in approach is a broad scanning of the environment with little effort to concentrate attention on specific current problems. The inside-out approach is more directed and takes into account the current structure of the business and issues being deliberated. It is also focused on a shorter term (1995). Most pre-venture environmental scanning will begin as outside-in, not just because the business structure itself is not apparent yet, but also because it is necessary to scan widely to identify those areas that will need concentration.

Entrepreneurs are almost always advised to prepare an initial business plan for the creation of a new venture. They are told this is an important first step by educational institutions, governmental institutions and many self-help books. There are also many business plans currently available on the internet and a 2002 estimate by D. E. Gumpert is that 10 million business plans are written each year (as cited in Karlsson, 2007, p. 1). There is even a business plan entry in the "For Dummies" series.

A crucial part of the business plan is the environmental scan. This can be a brief overview including only a description of the new venture's industry and potential market or it can be a very detailed segment strategy based on solid market research. A detailed segment strategy will result in sales projections that are more likely to be accurate because they are based on a more thorough understanding of the market. The creation of a document called "the business plan" has been studied to determine the effect it has on the success and survival of an enterprise. These efforts arose out of data that indicated that a number of very successful enterprises had been started without a business plan, and the fact that many other business plans were written and then placed in a drawer and never used. For instance, one study in the 1980's of the INC 500 found that 51% of these firms had started without business plans and those without them were more profitable (Castrogiovanni, 1996).

What this controversy, and the research it spawned, have revealed is that it is very difficult to tease out the effects of something that is a process, and an iterative one at that. Rarely contested, however, is the value of understanding a new venture's marketplace, its competitors and its customers. Necessary information about possible customers or clients, competitors, regulatory environment, and market trends is either acquired before the venture begins or it is learned in the 'school of hard knocks' afterward, but the basic information is key to many of the most important decisions the entrepreneur must make. Many nascent entrepreneurs struggle with finding necessary information and spend a substantial amount of time trying to fill in the blanks. One of many articles of advice on the process highlights this frustration with its title, "Unearthing Market Research: Get Ready for a Bumpy Ride" (Klopper, 2000).

It's also a frequently asked question at Small Business Centers (Harford County Public Library, 2008) and on Entrepreneur.com (Robbins, 2001). This phenomenon of multiple barriers to finding useful information is familiar to librarians. Typical barriers are rapidly approaching deadlines, misunderstood or unknown resources, and lack of time to devote to the process. The information search can be frustrating because it can feel as if it is time being wasted from the entrepreneur's goal of developing a business idea into a working enterprise.

Another possible factor at play can be described by the principle of least effort. This is a very general theory proposed in 1949 by George Zipf of Harvard University. It states that people are rational actors who estimate the amount of time associated with tasks such as finding information and then seek to minimize that time and effort. Information will be accepted even if it is lower quality because it is 'good enough' and the search can be terminated (Case, 2005). Continuing, Daniel Forbes' research into new venture creation noted that an entrepreneur was more intense in his information search if he had no prior entrepreneurial experience (1999). This suggests that the new entrepreneur is less likely to accept his own judgment as to what is 'good enough'. Whether the effort was in-depth or superficial, the better the information found, the better the decisions that were made upon it.

After startup, no matter what initial effort was expended, an entrepreneur will be motivated to ignore environmental scanning because of the immediacy of many other activities. A list of activities identified as critical to success include product development, marketing and advertising, selling the product, closing the sale, delivering the product, and following up with service (Sung, 2005). All six of these activities compete for the attention of the entrepreneur with the latest crisis often driving the focus of daily activity. This natural emphasis on the short-

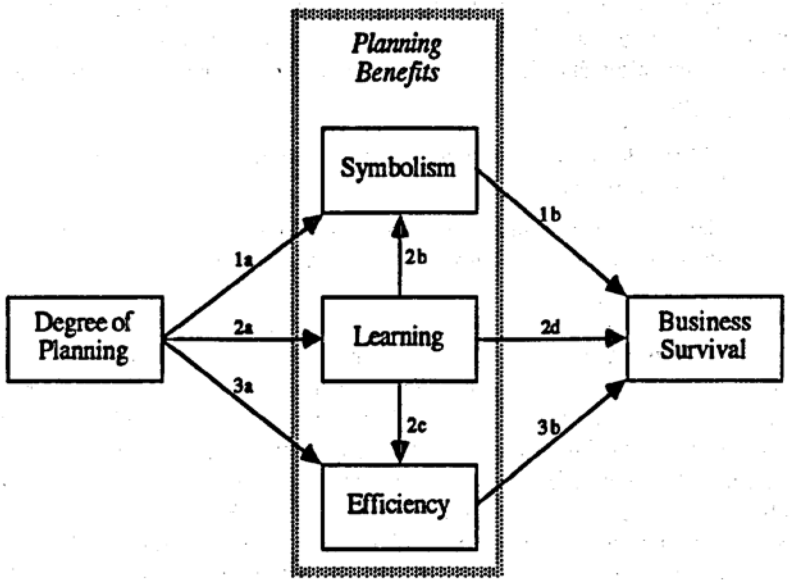
term problem is, of course, not confined to small business, but the nature of a typical one-person management structure makes it more acute. However, there is research that indicates that the small business owner does care about the external environment, even more than the managers of larger firms (Johnson & Kuehn, 1987).

## Literature review

As mentioned earlier, much of the research on environmental scanning is embedded in the research on business plans as a whole. There is also research that suggests that many successful entrepreneurs do not complete written business plans. However, there is little research that captures the behavior of entrepreneurs who utilized environmental scanning but did not write a business plan.

To increase understanding of this information behavior, research on small and medium-sized enterprises (SMEs), as well as those identified as 'entrepreneurial' firms, was reviewed. In our review, SMEs were defined as businesses with less than 500 employees (Nkongolo-Bakenda, 2003) and 250 employees (Mohan-Neill, 2006).

One of the difficulties in understanding pre-startup versus post-startup environmental scanning is that the detailed questions about the relevance and importance of various information sources that are common in studies of this information behavior are not typically asked in research on pre-venture scanning. For example, Rolland LeBrasseur included the variable "conducted market research" in his examination of the influence of pre-startup activities on growth and performance. He bundled it, however, with 10 other variables in his "Pre-startup Index." In his conclusion, he recognized that this bundling may have obscured some important information about the different impact each one has and recommended further study (LeBrasseur, Zanibbi, & Zinger, 2003).




*Note:* Arrow labels (e.g., 1a, 2a, etc.) correspond to Propositions presented in the text.

**Figure 1. Benefits of Pre-Startup Planning**

Illustration above from "Pre-startup Planning and the Survival of New Small Businesses: Theoretical Linkages" by Gary J. Castrogiovanni, 1996, Journal of Management, 22, p. 807.

In 1996, Gary Castrogiovanni sought to examine pre-startup planning and its relationship to performance. Recognizing that the issue is complex and involves many variables, he created a model to illustrate and clarify it (see Figure 1). As the model shows, he links planning to business survival by describing three benefits of planning: learning, symbolism and efficiency. His study describes two different types of learning, proactive and enactive. "Proactive learning occurs when managers absorb knowledge from the world around them (p. 806)." Enactive learning describes the process of creating knowledge out of direct experiences, acting first and then drawing conclusions. Using this definition, environmental scanning is obviously a type of proactive learning.

The second benefit of planning in Castrogiovanni's model is symbolism. Symbolism benefits the business because the written plan "legitimizes the new venture" (p. 804). It also serves as a primary communication tool to outsiders, particularly venture capitalists. Finally, efficiency is a benefit of planning as the process can improve communication to team members (p. 808). All of these benefits of planning contribute to the survival of the business.

The part of his argument that is pertinent to this research is described by his propositions related to learning, since environmental scanning is a type of proactive learning. Proposition 2a states that the "degree of pre-startup planning is positively associated with proactive learning in that planning enhances a founder's knowledge about the proposed business" (p. 806). He proposes two hypotheses for the relationship illustrated in Figure 1 as 2d. In 2d.1, he posits that "proactive learning prior to the startup is positively related to business survival" and in 2d.2 that "proactive learning prior to the startup is negatively related to the response time needed to address changing conditions (p. 808)."

There have been other ways that researchers have tried to measure environmental scanning, focusing mainly on scanning done by businesses already in existence. The preponderance of the studies are concentrated on identifying the types of information most often sought and the sources of these types of information. One of the earliest studies of environmental scanning in small- and medium- sized enterprises was done by Johnson & Kuehn who divide the external information needed by organizations into five categories: economic conditions, government, growth potential, marketplace and technology (1987). The research attempted to find out if the nature of the information sought was a predictor of the choice of the source.

In 1995, Sumaria Mohan-Neill investigated the environmental scanning activities of firms in order to discover the impact of the age and size of the organization on environmental scanning. She divided marketplace information into two types: remote and immediate. Remote marketplace information included demographic, population and socio-cultural trends. Immediate marketplace information included customer characteristics, opinions, and behaviors; market growth and segments; competitors' strategy, sales, market share and services; and new entrants.

She also divided the data collection methods into two segments, formal and informal. Formal methods included focus groups, surveys and database research and informal methods included reading current periodicals and networking. She found that as firms aged and grew, so did environmental scanning (Mohan-Neill, 1995).

Jean-Marie Nkongolo-Bakenda studied "globally-oriented" small and medium-sized enterprises to identify how these companies gathered the information they needed to compete. He noted that much of the information firms needed to be competitive internationally was information that could not be obtained by personal experience or the local business network. Nkongolo-Bakenda characterized six areas of "explanatory dimensions": customers, technology, regulatory, socio-cultural, economic and competition. (2003).

He also asked an open-ended question to elicit specific information sources used in environmental scanning. This resulted in a list of twenty possible sources which were first organized from most often to least often mentioned without specifying what information was being sought (p. 30).

When the responses were sorted by type of information sought, the highest source for market information was customer contact at 43%, followed by contact with dealers and wholesalers at 18%. His respondents said that trade shows and fairs were the best sources for competition (33 percent) and technology (48 percent) and reviews and other specialized publications were the best source for regulatory (38 percent), economic (63 percent) and socio-cultural (28 percent) information (p. 31). His research found that scanning was "contingent on many factors…and should be (considered) in relation to their accessibility by the firm and their value in reducing uncertainty in the most important sectors of the firm's environment" (p.48).

K. G. Fuellhart studied, among other aspects, the frequency of use and the qualitative assessment of the information sources used by SMEs. His list of information sources also included customers and trade shows but he characterized the Internet as "database/online searches" (2003, p.237). At a total of sixteen, his list was shorter than Nkongo-Bakenda but both, like all the other researchers mentioned, did not list business librarians and/or any other information professional.

In 2006, Sumeria Mohan-Neill undertook further research into environmental scanning, this time looking at online information searching. She found that there is a positive correlation between online environmental scanning and sales growth. Online market information and environmental scanning activity (OMIESA) is positively correlated to size of firm. Also. in earlier research, she had found that this positive correlation held for traditional environmental scanning as well. However, it is interesting that there is still more scanning going on in larger firms no matter whether it is traditional or online (Mohan-Neill, 2006).

## Research Design and Measurement Issues

As there has been limited research on the changing patterns of environmental scanning, our first stage of this project, and the focus of this paper, was to construct instruments to capture the type of activity that we wish to study. Environmental scanning will be operationalized using the measure of amount of time (number of hours) spent in scanning. Based on the literature, we believe that entrepreneurs will diminish the amount of time spent on environmental scanning once the venture is underway. Accordingly, we offer the following hypothesis:

Hypothesis 1: After startup, many entrepreneurs decrease the amount of time spent in scanning their environment.

As Castrogiovanni noted, it can be difficult to directly relate planning, (in this case, the subset environmental scanning) to success. After all, success is the result of many factors including the overall economy and the specific industry. As a result of this difficulty, there have been a number of measures utilized in prior research to operationalize success. Roland LeBrasseur used sales volume and a subjective measure of profitability. This subjective measure was determined with a question to the respondent, asking if the firm was a) not yet profitable, b) at breakeven or c) very profitable. This measure was also supported by earlier research on entrepreneurs (2003, p. 320).

Our research will operationalize success using two methods, 1) LeBrasseur's subjective measure of profitability and 2) actual sales volume versus projected sales volume. However, the time frame will not be annually, as was done in his study, but will be on a quarterly basis. As the questions will be asked during the first year of operation, it is likely that many firms will be in the "not yet profitable" category. To address this issue, actual sales volume will be measured against the projected sales volume from the initial business plan. If the firm is "not yet profitable", it still will be considered successful if it is meeting or exceeding its targets. According, we offer the following hypothesis:

Hypothesis 2: Entrepreneurs who continue to scan at the same or increased rate as they did prior to startup are more successful.

The principle difficulty we foresee will be the identification of entrepreneurs in an early enough stage to avoid the biases of imperfect recollections about the past. To address that issue, we will use a continually-updated database of new businesses available at our university. It can be searched by geographic area and/or by specific time frame. We will select the most recent group of new businesses, and then select the size of geographic area that would give a final sample size of at least 100 firms (Lewin, 2005, p. 218). A recent query of the database resulted in a list of 4,207 new businesses started in a targeted Metropolitan Statistical Area between June 2008 and December 2008. A telephone call asking the dichotomous question "Did you formally research your business idea?" will be made to an entire list from the MSA. If the answer is yes, the pre-venture questionnaire would be administered. If, in the future, the rate of new business formation remains the same and only 20 percent answer yes, that is still over 800 firms. A recent meta-analysis of response rates suggests that telephone surveys can expect response rates ranging from 24 percent to 97 percent (Manfreda, Bosnjak, Berzelak, Haas, & Verhovar, 2008). Accepting the lowest response rate, a six-month MSA list should still give around 200 responses. If the first list of start-ups does not reach a threshold of over 4,000 firms, a larger geographical area will be selected.

This initial telephone survey was designed to capture the recollections of the entrepreneurs from the previous six months. There will be four questions about pre-startup scanning that will address how long it took, what types of information were sought, was there quantification of the market information, and did the entrepreneur have help with the scan. The demographic questions will include the date of venture startup, the type of business, actual and/or projected sales for at least 8 quarters, number of employees and financing issues.

The post-startup survey will be administered at the same time to those firms which have existed for at least six months, whereas the newer firms will be re-contacted at their six month date. These questions include a dichotomous question about current environmental scanning and also two of the same questions as in the pre-startup survey about types of information and help. There will be an open-ended question on how the entrepreneur's opinion has changed about the importance of the types of information, if at all, and questions about how often s/he scans and how much time is spent in that activity. The telephone interview questions are in Appendix I and the telephone script is in Appendix III.

Permission to send a follow-up questionnaire will also be asked at the first contact. The follow-up questionnaire will address further questions about information sources. Little or no research has been done specifically on the sources of information that are used by entrepreneurs to develop their first business plan. This follow-up questionnaire will use many of the same questions that are used to measure ongoing environmental scanning to determine the pre-venture scanning. In this way, it can be linked to the previous research on environmental scanning and possible further avenues of research may be identified.

The characterization of types of information developed by Nkongolo-Bakenda and Fuellhart's list of sources will be used in this questionnaire. Fuellhart's list has been modified to include business libraries and librarians in order to learn how many entrepreneurs know about these resources. Further, business databases will be listed as a separate source from online searches in order to distinguish between general search engines such as Google, and specialized databases, even though the databases are also online resources. The follow-up questionnaire is in Appendix II.

A further refinement of the categories will be measuring whether the sources are primary (those that necessitate the entrepreneurs participate in the creation themselves) or secondary resources (the entrepreneur can be a passive user of information). This categorization will be done after the surveys have been completed.

## Further Research/Implementation

This paper is the first in a series on environmental scanning done by entrepreneurs. Given the limitations of previous research in this area, the focus has been on reviewing what has been done, creating hypotheses, and developing the research instruments. Future research will focus on implementation. Implementation of stage one will be to test the script and questionnaires for clarity. Two faculty members in the authors' College of Business Administration will be asked for commentary and then the questions will be tested on a small group of entrepreneurs from a different geographical area than the proposed survey area. These entrepreneurs will be asked to comment on the questions and offer suggestions on how to best elicit the information sought.

Once that has been completed, the next stage will be to conduct the full study. A call list will be created, and data will be collected. The data will then be examined and the hypotheses will be tested.

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## Appendix I

**Pre-venture scanning:**

1. How long did it take you to complete the environmental scan on your business idea?
2. Which types of information did you consider important?
    a. Customers/demographics
    b. Technology impact
    c. Competitors
    d. Regulatory issues
    e. Economic climate
3. Did you quantify your market? Specifically, did you...
    a. Estimate number of customers?
    b. Estimate average purchase?
    c. Estimate the frequency of purchases
    d. Estimate number of competitors?
4. Did you purchase any information or hire anyone to do the scan for you?

**Firm Characteristic questions**:

1. When did you open your business?
2. What type of business are you in?
3. What are your actual sales in the most recent quarter?
4. How does that differ from your pre-launch projected sales?
5. How many employees (not counting yourself or partners) do you have, if any?
6. What percentage of your venture is self-financed?
    (Self-finance is defined as money from you or blood relatives)
7. May we send you a brief follow-up questionnaire about information sources?

**Post-venture scanning:**

1. Do you do environmental scanning now?
2. Does anyone else do environmental scanning for you, either within or outside the firm?
3. Which types of information do you currently consider useful?
    a. Customers/demographics
    b. Technology impact
    c. Competitors
    d. Regulatory issues
    e. Economic climate
4. Did your opinion on what information is useful change after start-up and if so, how?
    _____
5. If you do environmental scanning now, what do you do with the information you collect?
    a. Keep it in mind
    b. Update sales forecast
    c. Share with others in the business
    d. Update written plans for the future
6. How often do you look for this kind of information?
        i. Daily
        ii. Weekly
        iii. Monthly
        iv. Never
7. Given your answer to the above question, how much time do you spend looking?

## Appendix II

Follow-up Questionnaire

The instructions are below. Following is the template for the questionnaire. Each category will have its own page, and the categories are: Customers, Technology, Regulations, Economic Conditions, and Competitors.

Please put a check mark in the appropriate box to score the list of sources in terms of their usefulness for each type of information. There is a list for each kind of information that might be needed for business decisions. If there is a type of information or a source not listed, please write them down on the back of the last page.

| USEFUL source for information about CUSTOMERS | Strongly agree | | | Neither agree or disagree | | | Strongly Disagree | NA |
|---|---|---|---|---|---|---|---|---|
| Personal experience | | | | | | | | |
| Conversations with vendors/ reps | | | | | | | | |
| Conversations with potential customers | | | | | | | | |
| Conversations with customers in your current business | | | | | | | | |
| Reading trade publications | | | | | | | | |
| Reading general business news | | | | | | | | |
| Catalog/promotions literature | | | | | | | | |
| Trade shows | | | | | | | | |
| Purchase market research | | | | | | | | |
| Consultants | | | | | | | | |
| State/federal/university assistance programs | | | | | | | | |
| Business databases | | | | | | | | |
| Business library/librarian | | | | | | | | |
| Online searches | | | | | | | | |
| TIME SPENT ON THIS TOPIC (indicate minutes or hours or in the most appropriate box) | | Per day | Per week | Per month | Per year | None | | |

## Appendix III

Telephone script A

Hi, this is _____. I am a business student at XXX University conducting a very brief survey on entrepreneurs. May I please speak to _____ (name or "the owner of the business")?
Thank you for speaking with me. We are investigating the business research/ planning of entrepreneurs. Did you formally research your business idea? If no: Thank you for your time. If yes, proceed to script B.

Telephone script B

I have a few questions about the environmental scanning you did for developing your business idea. As you no doubt know, environmental scanning includes finding information about your potential customers, your competitors, regulations which might pertain to your business, and the general economic climate.
[Ask the first 4 questions.] Thank you. Now I'd like to ask you a few questions about your business. The information you share with me will be recorded with your answers to the previous questions but will not be associated with your name or your business. All information will be strictly private and for research purposes only. The research is being conducted under the XXX University Human Subjects Research guidelines. [Ask the next 6 questions.] Thank you very much for supporting our research. [Ask Question 7. If yes, confirm address.] Thank you again for your time.

# A STRATEGY FOR FAMILY BUSINESS SUCCESSION PLANNING

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## Abstract

The research data contained in the paper deals with family business succession and could prove beneficial to any business owner or manager dealing with succession planning whether or not it is a family business.

The first pressing issue is that businesses do not have succession plans in place. This could be due to several factors including: founders have the mentality that they won't retire or feel a loss of self-efficacy; also the talks brought about can be deemed as taboo, perhaps because generational gaps affect the psychological mindset; or maybe because the theory of primogeniture is outdated and no longer a viable option. For whatever reason it may be, the statistics don't lie, and it has been found that roughly 70 percent of business successions don't work and 70 percent[7] of businesses have no succession plans in place.

Because of the astonishing high rate of failures in business succession, this work is presented to help family business owners deal with the issues involved in creating a strategy and a method to produce and implement it.

## Introduction

A family business is a company that two or more members of the same family own or operate together or in succession. Succession is the act of succeeding another and the right to do so; as defined by Webster New World Dictionary. Family Business Succession is the act of succeeding an organization to a family heir or the decision to sell the business to another party. This paper is aimed at describing the reasons for having a succession plan, the process for creating a succession plan, and helpful means to the formulation and implementation of the succession plan. Why, one might ask, is it important for family businesses to create a succession plan? As one author put it, "businesses are tenuous things; if your family is out squabbling about what is going to be done with this asset; the business is going to suffer." As well, almost every research article/journal written about succession planning states that more than 70 percent of family-owned businesses do not survive the transition from founder to second generation. What can be even more startling is that only 5 percent to13 percent of family business transitions are completed to third generations. With the failure rate of transitions from one generation to the next, one may be inclined to ponder on why companies do not create these strategies. Another study conducted by New Jersey Law Network found that 60 percent to 70 percent of all family-owned businesses have no succession plan in place. This paper will first discuss reasons why family businesses do not have succession plans and then follow with steps to help begin and create the succession plan.

## Reasons for why Businesses Don't Have Succession Plans

In lieu of these findings, one must discover why family businesses don't create succession plans when the failure rates are so astonishingly high. There are a multitude of reasons for why businesses don't use them and one could be associated with the fact that the successor does not believe that the predecessor will ever retire. A recent study conducted by Arthur Andersen's American Family Business Survey found that between a quarter and a third of leaders of family businesses either don't intend to retire or plan to remain involved in some capacity in the business throughout their lives.

Another justification of this is that the talks of succession are such a taboo subject in the family because it deals with money and death. The United States is notorious for lagging in communication about money and death, and mixed in with the greed the western civilization is infamous for; it is no wonder why communication of these issues are never brought to light. As Susan Ward put it; "succession planning can be especially complicated because of the relationships and emotions involved - and because most people are not that comfortable discussing topics such as aging, death, and their financial affairs." Author Dan Chase stated "often, the most difficult aspects of transferring ownership are the very things that aren't or can't be said. The mindset of the parent, getting ready to cede control, and that of the next generation looking to take over may make it challenging to even begin the conversation."

Chase continues his argument by explaining that "there's often a great bit of themselves (business founder) tied to the business. You are dealing with the retirement of someone who might consider the business their baby." The problem associated with this is the consideration that the business could be the founder's self-identification, and bringing their retirement front and center could lead to severe depression or lack of self-efficacy by the founder. A study concluded that the average founder of a family business has 90 percent of their assets tied up in that business; and a subjective 110 percent of their self-esteem. This often leads the successor to a difficult and daunting task of trying to figure out when and how to address a succession plan without the predecessor taking their comments as "when am I going to die?"

A counterpart to this discussion is through the founders' point of view. Whereas the problem dealt with thus far has been with the successor being unable or uncomfortable with communicating finances and mortality with the founders; the founders can be just as unlikely to not being able to start the discussion with the successor. The founder could have problems with turning over "the keys" to the successor if they perceive them as not wanting to take over or content with where they are in their current occupational situation. As well, the founder may have a false observation that the successor does not want the financial burden/risk of taking over, as Chase put it "They don't want me (founder) to take my name off the bank note, they don't want to put their own personal property on the promissory note."

The founder may also harbor animosity by thinking that the younger generation "does not work as hard as we did" which in turn is countered by the successor responding back that "they have a better work/life balance." All of these scenarios are produced to explain some of the mental backdrops of why succession plans are sometimes forgone and never spoken of. Another well noted challenge is that generational gaps produce different strategies and totally different ideologies. As S. Kelly stated in the Los Angeles Times, "What's worked for the last generation probably won't work for the next generation. The world has changed; the market has changed; there's new competition; and there is a need to develop new strategies. The older generation very likely wants to continue doing what they've been doing. The younger generation will want to do things new ways and there are going to be extreme conflicts about the direction of the business." This produces another factor that can detour the plans; because the founder doesn't want to think that "his baby" will be put in the hands of another generational thinker whom will change the course and strategy of their current business.

A last issue is that of primogeniture; the right of the first-born child, usually the eldest son, to inherit the parent's estate; isn't as popular as it once was. Buck Brown of the Wall Street Journal first stated that, and he conceptualized it by stating that it is due to "women's liberation and the recognition by family-business owners that lines of succession should be based on merit, not on age or sex." Kelly continued this argument in his LA Times column by stating that "If several members are being considered for leadership; it has the capability of producing intense emotional echoes in the family." John Ward, a Loyola University of Chicago Graduate Business School Professor stated that only 10 percent to 15 percent of the family run companies in the previous generation tried to involve more than one family member in succession; compared to half of family businesses now facing the succession question. The greater number of children involved in family-business coupled with the bear market and corporate lay-offs in the present economy is creating an influx of family members into the business which poses a greater risk of failure for the succession. The underlining principle in this argument is that founders are uncertain as to whom they will turn over the company to, and in search of harmony in family life away from the business, they do not want to deal with this scenario. The founders will take the mentality, "if I die; then they will have to decide amongst themselves how to pick a leader." Thus, the founders purposely avoid the succession planning as to avoid the squabbling that will result in the family. With all of these facts in mind, it is clearly seen why only 30 percent to 40 percent of family businesses have plans in place. However, this is also exactly why founders should create a strategy and quit avoiding/postponing the implementation of one. The recommendations below are set out to help the founders create these strategies and the discussions related to each topic.

## Grassi and Giarmarcos' 5 steps to succession planning

According to Sebastian V. Grassi, Jr., author of *A Practical Guide to Drafting Marital Deductions Trusts* and Julius H. Giarmarco, a frequent lecturer on a national basis to insurance companies and co-author of several books with Grassi; they conclude that there are essentially five levels to a family business succession plan, which will be used as a basis for this theory.

1) The first level is to determine the business owner's long- term goals, his/her objectives for the family business, and an addition to Grassi and Giarmarcos' list which deals with life insurance and business interruption insurance.

2) The second level is to determine the financial needs of the business owner and his/her spouse and to develop a viable plan that assures their financial security.

3) The third level is to determine who will manage the business and to develop the management team. It is important to recognize that management and ownership of the business are not the same. The day-to-day management of the business may be left to one child, while ownership of the business is left to all of the children (whether or not they are active in the business). It is also possible that management may be left in the hands of key employees (or outsiders) rather than family members.

4) The fourth level is to determine who will own the business and how to transfer (gift, sell or devise) the owner's interest in the business to the "new" owner(s).

5) The fifth level is to minimize transfer taxes and to prepare an appropriate estate plan.

## First Stage

The first stage of creating a solid succession plan is to determine the business owner's long-term goals and their objectives for the family business. As Chase Dan put it "tell them what your goals are, and have them come up with a battle plan – measures that can provide a course of action for the next few years."[10] By gaining an understanding of the predecessor's objectives, it helps advisors establish an appropriate blueprint for transitioning the business. This brings about a major point under this stage; that being establishing an advisory board. An advisory board is comprised of third party outsiders and the members are not family business consultants. They are trained or experienced in dealing with family business dynamics (like accountants, financial planners, attorneys, judges, physiologists, and etc.). Don Schwerzler, the founder of the Atlanta-based Family Business Institute, which was the first full service, multi-disciplined consulting company organized to serve the unique and complex issues that confront and confound families in business together, developed the *ABC Process*.

## ABC Process

The *ABC Process* stands for Advisory Board Coaching Process; which is a succession management program that takes the uniqueness and complexity of family business succession into account and helps formulate plans that will succeed. Schwerzler states that it takes 6-24 months to prepare for the initial Advisory Board (AB) meeting, meaning that the initial succession plans must begin a half-year to two years before the actual process of creating it begins.[16] The ABC Process is comprised of four steps and is generally done over a two-day period; however, a company owner can create their own process using these guidelines and implement it over a longer/shorter period of time if they so choose.

1) The first step is the family business assessment. This usually takes place over a family business dinner meeting and includes the extended family (all available children and their spouses.) It is a structured meeting, but kept informal so that communication can flow freely. Issues such as the history of the company, present and future situations, and goals of each individual are discussed and learned by the board.

2) The second step is a series of one-on-one interviews with all of the family members as well as key employees that are not part of the family. These have to be conducted very professionally and considered of utmost confidentiality so that a free line of communication exists and ideas can be exchange without fear of reprimand. The interviews help to establish the goals shared amongst the most members and are a crucial concept to enabling the succession process to be successful.

3) The third step is creating a "to do" list for the family and the business and agreeing on a time frame for completion. Part of the challenge in this step is the functioning chemistry between the family and board members. The board is there to assist and keep a continuous flow of organized work moving, so they must be aligned in the goals of the business.

4) The final step is for the Board to help conduct the first few meetings of the succession plans and ensure the success of them. As Schwerzler put it, "ABC Process and the Advisory Board create a safety net for the family and the business should the family business be struck by a catastrophic event such as the unexpected death of the business owner."

Once the advisory board is in place; the business can compare the present situation (based on the advisors' observations) against the owner's objectives and determine if they are in alignment with reality or if there is a high probability of them being deemed as "unrealistic." Dan Chase states that "as simple as it might seem, a succession plan should be approached realistically. A business doesn't one day switch owners, with the parent handing over the keys, while all day-to-day operations continue to run as usual."[10]

## Life Insurance

Under the first stage, insurance requirements should also be addressed. Life Insurance (LI) for founders that have business partners, could be critical to the ongoing operations and allow for the succession plans to actually be needed and used. The death of one business partner could result in substantial loses for a business, and could force a business into liquidation. Therefore, one of the most important things for the founders to establish before a succession plan is their LI policy. Life insurance is a contract between the insurer and the policy owner whereby a benefit is paid to the designated beneficiaries if an insured event occurs which is covered by the policy.[18] The value for the policyholder is derived not from an actual claim event, rather it is the value derived from the "peace of mind" experienced by the policyholder due to the negating of adverse financial consequences caused by the death of the life being insured. LI can be taken out by a third party on the founder's life, so long as the third party has an *"insurable interest"* in the insured's life. In the case of a 3rd party holding a policy on the predecessors' life, the policy is referred to as the *"celui qui vit"* (or CQV.)[18] Under normal insurance operations; close family members and business partners/successors' are found to have this insurable interest because they can show that they will suffer "*actual lose resulting from the death of the insured."* One of the major facts that must be considered is choosing the right beneficiary. Just because a founder assumes that their business partner/successor will use the payment for the continuation of the business doesn't mean that it is the truth. The founder must make sure that the beneficiary wants to keep the business going and will use the policy to do so instead of cashing out the policy and liquidating the business. Some strategies to overcome this issue are:

1) If a business is incorporated, then one way to insure that the payout stays with the business is to include '*plain English*' writing in the incorporation papers stating what is to be done with the LI payment.

2) If the company is not incorporated, then the beneficiary of the policy could be a trust set up in the business' name. Because the business itself is a legal entity; it can be a receiver of the policy payment. Under this trust, the owner (insured) can set requirements for what can be done with the money in the trust.

3) The policy can also be set so that it has a large enough payout for a business partner/successor to have the ability to buy the remaining part of the business. If this is used, then the insured party and their family will receive monetary benefits equal to the fair market value of the business times the percentage owned by the insured. This is done so that if the new owner does in fact want to liquidate the business, the others will still receive the full benefits of what they owned.

These methods must be given vast consideration in case problems arise; such as the surviving spouse not wanting the business or the surviving family does not want the business. In any such case, having LI with a correct beneficiary and means by which the money is used in the instance of death will provide peace of mind and a reduced amount of anxiety upon the aftermath of the deceased. After the correct beneficiary is chosen, the right policy should be decided on.

Proceeds from the LI policy could be paid in a lump sum or you can choose to take the payments as an annuity. An annuity is paid over time in regular recurring payments for either a specified period of time or for the beneficiary's lifetime. There are three main types of LI policies that a business owner can choose from and the effects of each one should be weighed and discussed when making the decision.

1) *Term Life Insurance*: This provides LI coverage for a specified term of years at a specified premium. The policy will not accumulate cash value and is generally considered to be "pure" insurance where the premium simply buys protection in the event of death and nothing else (incapacity to function). There are three main factors that should be considered in term insurance: (1) the face amount (protection or death benefit), (2) the premium to be paid (what it will cost to be insured), and (3) the length of the term.

2) *Whole Life Insurance*: This provides for a level premium guaranteed by the company. The biggest advantage is its use is its guaranteed death benefits, cash values, fixed and known annual premiums. However, the premiums are inflexible; which could provide for a low level of internal rate of returns that does not compete with the competitive market or other savings alternatives. Riders can be purchased however to allow for the use of policy dividends, but they are not guaranteed and could result in lower returns then the historical rates may show. As well, premiums for whole LI can be much higher than term insurance in the short-run, but the premiums will equal out if the policy is keep in force until the average life expectancy.

3) *Universal Life Insurance*: This intended to provide permanent insurance coverage with greater flexibility in premium payments and the potential for a higher internal rate of return. A universal LI policy includes a cash account and the premiums increase this. Interest is paid within the policy on the account at a specified rate, and then administrative costs are charged against it. Universal can be more preferable over whole life because it pays interest based on rates that move with the financial markets. The cash value is easy to obtain because the owner can discontinue premiums if the account reaches the desired level.

Riders, which are modifiers to the insurance policy, can be added at the same time the policy is issued. There are many forms of riders that can be purchased, but one that should be divulged further is a *joint life* rider. This insures two or more lives with the proceeds payable on the first death. This is another way for business partners/successors to insure each other.

## Business Interruption Insurance

A second type of insurance that should be purchased is Business Interruption Insurance (BII), which will protect the entity in case of some interruption in the normal business operations. Business interruption coverage is not sold separately. It is added to a property insurance policy or included in a package policy. This type of insurance works a lot like flood insurance, but will cover more areas than just a single force of nature. They are more expensive to purchase, but can be the lifeline of a business in case of emergency. Depending on which type is purchased, the BII can cover things such as; floods, earthquakes, tornadoes, fire, or in the death/incapacitation of the business owner. BII will compensate you for lost income if your company has to vacate the premises due to disaster-related damage or if the doors have to be shut do to the death/incapacitation of the owner. It covers the profits that would have been earned based on historical financial records had the disaster not occurred. The policy will cover everything from electricity bills to storage building fees. It is imperative to insure the policy limits are sufficient to cover your company for more than a few day, and to understand that the normal operations of BII does not start paying out until the 48-hour waiting period has expired. As stated the price of the policy is not cheap and the premium will be adjusted to the risk of the business; meaning that the price for BII will be higher for a restaurant then a real estate agency because the restaurant has a greater risk of fire than the latter. A rider to the policy can include extra expense coverage in case you have to carry on business at a different location because of insured damage at your original place of business. This can also be a wise BII investment.

There are various types of business interruption coverage's available, and with guidance from a BII underwriter, a business owner should not have any trouble finding a policy that fits their needs. Before any insurance is purchased, you should first seek advice from an insurance agent that specializes in life insurance and has a strong background in dealing with insurance for business partners/successors. As with any other topic discussed in this paper; you should always consult a professional of the respected industry to further your knowledge and find an answer that fits precisely with your goals.

In closing the first level involves establishing an advisory board, determining/understanding the predecessors' objectives, ascertaining the present situation, examining the reality of the situation, and making realistic approaches that achieves the objectives of the business. As well, one needs to educate them self on the need of life insurance and/or business interruption insurance, then selecting and choosing the best policies that meet the needs of the family business. The insurance should be handled before any other item on the list so that the owner is covered during the creation and implementation of the succession strategy in case of a catastrophic happening.

## Second Stage

The second step in creating the succession plan is to determine the financial needs of the business owner and their spouse so that the plan develops a viable insurance of the predecessors' financial security. Several questions can be helpful under this step, like:

- Will the business be able to support the owner and their spouse after the succession?
- Can the business also support the children, who are now the "new" owners?
- If not, should the business be sold to a third party?

Many experts suggest that a retired individual can live on roughly 80 percent of their working salary; however, that number is often unrealistic. This is due to the fact that often the financial needs surpass 100 percent of their late income because now the possibility of travel, gifts to family, extra money spent on grandchildren, and the "Depression-era" mentality (which is the attitude of "not having enough money") all can take the predecessor over and beyond their former income. This is pointed out to make sure that during the second stage the plan incorporates all of these thoughts and does not make unrealistic approaches to the financial security of the predecessor by under/over stating the amount they will receive.

## Third Stage

The third step in the strategy is determining who will manage the business and developing a management team. Under this stage, it is crucial to recognize that management and ownership are not the same and ownership will be dealt with in the fourth step. It is likely that management could be left in the hands of key employees (non-family) while succession of the ownership still remains with the family. Grassi and Giarmarco state that the business owner must learn to delegate and work "on the business" and not "for the business" so that the management of it will successfully transition into the hands of the next generation or another key employee. A general rule of thumb is that it takes three to five years to select, mentor, and train the new management successor. Therefore, the successor mentorship should be one of the first plans of actions for a successful plan.

## Primogeniture

One of the reasons pointed out for the lack of succession plans was the early ideologies of primogeniture, to which there are a couple of strategies to overcome the problem of having more than one child in line for control.

- *Executive Committees*: Under this method, a family turns over the company to two or more children who will run it jointly as an "executive committee."[12] If the company only wants one "head person," then they can take turns acting as active president rotating every year or two.

- *Split Duties*: The predecessor can give each child a different area of responsibility with equal importance. This can be done by dividing the owners stock equally and allowing each member to take over a department in which they are the strongest at, i.e. accounting, finance, management, human resources, sales, and/or any other individual departments that the firm has.

Buck Brown reported in the Wall Street Journal that 35 percent of surveyed family business owners plan to groom one child to take over, 25 percent plan to let their children compete and choose one or more successors with help from the board, 15 percent plan to let children compete and choose a successor without the help of a third party, and 10 percent plan to let them choose on their own. In lieu of these findings, it is imperative that the predecessor determine and put into writing how they plan to choose the successor or use one of the two methods to ensure that all children get equally the same. If not, the percentages shown will cause family squabbles and could ultimately lead to a destruction of the family business.

## Retaining Key Employees

Under this stage, it must also address methods to guarantee that key employees remain with the business upon the death, disability, or retirement of the predecessor. Grassi and Giarmarco give four techniques that can help to assure that the key employees remain with the management team.

1) *Employee Agreement*: A written employment agreement will establish the key employee's duties, compensation, and fringe benefits. To protect them, the agreement can establish a set term and provide them with a severance pay if their employment is terminated without cause (which would have to be defined in the agreement as well.)

2) *A non-qualified deferred compensation* ("NQDC") plan (sometimes referred to as a "golden handcuff" plan): This is an agreement where the business promises to pay the key employee a benefit at the loss of the founder. In return, the company gets continued employment through the specified term provided in the contract. The benefit is that neither the company nor the receiver has to report any payment until it is made; thus no extra taxes or expenses will have to be incurred. The tradeoff is that the company gets a promise from the key employee to not leave before the specified date, and the employee gets a promise not to be terminated earlier than the date. A violation on either party results in the loss of the benefits or the required payment of all salary that was promised.

3) *Non-qualified Stock option plans*: A contract between the company and key employees that give them the right to purchase a specific number of the company's shares at a fixed price and a vesting period is placed on them that sets the time standards for when they can be sold back. This helps motivate the employees to do their best and ensure that they will remain on the team as to maximize the profit until the shares can be cashed in. A general rule though, is to write into the contract that the shares cannot be sold to third party outsiders, but yet they have to be sold either back to the company of to the current owners (It must also be written that the selling of the stock must be voted on by the board and sold back equally to the group so if there are more than one owners involved, they remain equal with their shares.)

4) *A change of control agreement*: These generally provide that the key employee's terms and conditions of employment (i.e., duties, compensation, benefits, etc.) will not be adversely changed for a set period following the transfer of the business to the next generation of owners. If they are fired, then the agreement will ensure that they continue to receive the amount agreed upon, as if they still worked there, for the length of the contract.

## Fourth Stage

The fourth level of the succession plan is to determine who will own the business and how to transfer the owner's interest in the business to the "new" owner(s). Chase Dan states that "the smartest family-business owners are the ones who can sit down and have the discussion about that which is undiscussable: 'my children are running the company. Now, how are we going to effectively get this out of my hands and into their hands?" Most family business owners would

rather leave the business to their children who are "active" (presently work for the company) as opposed to leaving it to the inactive children, but still would like to treat them all fairly. However, it must be stated for the record, under federal laws there is nothing about the legality of leaving different amounts to children, and as long as family members can prove that the creator of the will (or whatever document is used to pass on belongings) was of sound mind, then the courts cannot overturn decisions made about the inheritance of possessions. Meaning that if a founder did choose to leave the business to only one child in an unequal manner, it is not illegal (however it does not make it ethical either, but that is for another discussion.) There are two other issues that must be dealt with under the ownership topic:

- Whether the predecessor will continue to receive financial benefits after the transfer.
- Whether the predecessor will continue to control the business after the transfer.

When there are talks about ownership in families it can lead to some very harsh and objectionable situations. The predecessor must establish how to value the business, which can lead to problems. If they low-ball the value, then they may not have enough money to receive financial benefits after the transfer, inevitably meaning that they would not have enough money to enjoy their retirement. However, if they over-exaggerate the worth, they could present the successor with the inability to continue operations. Situations could also arise over the thinking by the successor that they shouldn't have to pay for the company because they worked to make it what it is.

## Techniques to Ensure Viability

All of these examples are part of the reasons that companies do not have succession plans. However, Grassi and Giarmarco give ten practices that can ensure viability of the continuation of the company through the transfer of ownership.

1) *Sell the Business to the Active Children*: The sale price would be set by third party auditors at fair market values, thus defeating the over/under valuation of the firm. The problem associated with this technique is that the successor must use after-tax dollars to make the principle payments, and the predecessor must pay capital gains tax on the payments as well as their ordinary income tax on the interest payments. Therefore the double taxation could prove that this strategy is not the most cost effective.

2) *Use Voting and Non-Voting Shares*: This method allows the predecessor to gift/sale the business to all children, while only transferring voting shares to the active children. This can be furthered by putting call options on the nonvoting shares to the active children, thus allowing the inactive children to receive the cash benefits of the company while retaining the ownership within the family. This liberates the squabbles of inequality of distribution of the parents' assets, while leaving the control of the company to the active children.

3) *Give Non-Business Assets to inactive Children*: This method is self-explanatory. If the predecessor is fruitful enough in his non-business assets so that they equal the equity of the business, they can pursue this method. Unfortunately, most founders have their entire lives tied up in the family business (assuming they were entrepreneurs) and are not blessed enough to have assets outside of the business worth as much as the business itself.

4) *Reward the Active Children for Their Sweat Equity*: If the active children have been more instrumental to success, give them credit for their involvement in the business. The credit can come in the form of lifetime business interests, and/or a larger portion of the business estate given to them. This again can pose severe problems if other siblings and/or family members view this as being unfair treatment.

5) *Equality vs. Fairness*: Under federal law (as explained earlier), children do not have to be treated fairly by parents in their inheritances, so give more to the active children. As stated previously, this could create major rivalry and battle between the family and is another option that might not be the best for the family life away from the business.

6) *Maintain Control by Retaining Voting Shares*: If more than one active child is in the business and you don't know who to give control to; keep the voting shares until you make up your mind. Remember to put those shares in a trust, however, so if death occurs, the active children equally get them.

7) *Establish Criteria for the Active Children to Receive Voting Shares*: When one or more active children are present, you can establish criteria that have to be met first before the voting shares are distributed. Usually the criterion involves situations such as getting a degree or gaining a set number of years of work experience.

8) *Provide the Business Owner with a Salary Continuation or Consulting Agreement*: this is a form of NQDC that can be used to provide the business owner with retirement benefits. If properly designed, the benefits paid to the business owner will be deductible to the business but taxable as ordinary income to the business owner. Alternatively, the business owner can remain as a consultant to the business and/or serve as a board member to receive some compensation.

9) *Provide Written Assurance to the Active Children*: Can enter into a buy-sell agreement*; giving the active child the right to ownership, but it still allows the owner to remain in voting power until death/retirement. The writing must be of a legal standard which usually involves multiple witnesses over the age of 18 and of a coherent mind (with their signatures), the predecessor of a coherent mind, and proof that the document was signed without undue pressure from another person

10) *Protect the New Business Owners with a Buy-Sell Agreement**: If properly designed and drafted, a buy-sell agreement will create for the departing owner a market for what otherwise could be a non-marketable interest in a closely held business. This will allow the active children to maintain control over the business by preventing shares from passing to the inactive children; and if the requirements of IRS section 2703 are met, it will in essence fix the value of a deceased owner's shares for estate-tax purposes.[13]

* *Buy-Sell Agreement*: a legal arrangement providing for the redistribution of share of the business following the death, disability, retirement, or termination of employment (triggering events) of one of the owners. The buy-sell agreement should also set forth the purchase price formula and payment terms upon the occurrence of a triggering event. The IRS is bound to accept the buy-sell price established between related parties and shareholders in a family business. They fight it, but tax courts will uphold if these hold true:

- It is not merely a device to transfer a business interest to heirs for less than fair market value
- The agreement is real it is part of a *bona fide* business arrangement
- It is similar to arrangements entered into by others in an arms length transaction

The important term is "*arms length*". Over- or under-valuation can lead to substantial tax penalties. Proper documentation of facts and reasoning is critical to sustainability. A business valuation will reflect these factors.

As shown, there are several ways to transfer ownership to the successor that can prevent family squabbles, which is one of the main fears of creating a succession plan. This also pointed out several factors that can allow families to discuss the plans without having to bring about the undesirable questions of morality and finances; therefore proving that succession plans can be created without having fear of the taboo communications. The final step will present ways to transfer the ownership in the most beneficial tax aspects.

## Fifth Stage

The fifth stage aims to minimize transfer taxes and helps to prepare an appropriate estate plan. Estate taxes can be very costly, claiming up to 45 percent of the value of the business, which could result in business having to liquidate or take on extra debt to afford the taxes alone. Currently, the federal estate tax exemption is $3.5 million, but is changing to $1 million in 2011. For the estates above the tax exemption amounts, the federal tax rate is 45 percent presently, and plans to step up to 55 percent in 2011. With the inauguration of President Barack Obama in January, these numbers are expected to climb even higher. He has already imposed a plan to tax businesses harder in the coming years and is just waiting for the approval from Congress so he can enact meaning. This means that the tax component of succession planning is becoming one of the most important issues there is to deal with. Estate tax planning should be done with an attorney as early as possible.

## Gifting Strategies

To avoid forced liquidation, there are a number of lifetime gifting strategies that can be implemented by the business owner to help minimize the estate taxes.

1) *Annual Exclusion Gifts*: Gifts of business interests up to $13,000 ($26,000 for married couples) in 2009 can be made annually to as many donees as the business owner desires. This amount is adjusted for inflation in increments of $1,000. Gifts not only remove the value of the business interests gifted from the business owner's estate, but also the income and future appreciation on the gifted business interests.

2) *Gift Tax Exemptions*: Business Owners can gift $1 million ($2 million for a married couple) during their lifetime. While the use of the $1 million/$ 2 million gift tax applicable exclusion amount reduces the estate tax exemption at death, such gifts remove the income and future appreciation on the gifted property from the business owner's estate. Unlike the estate tax exemption (which is $3.5 million in 2009), the gift tax exemption remains fixed at the $1 million level.

3) *Gifts of Family LLC Interests*: A family limited liability company (FLLC) is a standard LLC that only includes family members. It can be a valuable tool to transfer a business or business real estate to children at a discount from the value of the underlying assets owned by the FLLC. This is accomplished by gifting or selling minority interests or non-voting interests in the FLLC to the children (or to trusts for their benefit). In other words, the sum of the FLLC's parts is worth less than the whole. If the owner wishes to remain in control, they can keep 49 percent or less of the voting powers and team up with a friendly child that has enough voting power to give them over 51 percent. Or, the owner can keep 26 percent and give their spouse 26 percent, but in the case of death of one spouse, the 26 percent FLLC interest should be left to a trust for the benefit of the surviving spouse.

4) *Gifts in Trusts*: One advantage of making gifts in trust for the benefit of the active children is to protect them from their inabilities, their disabilities, their creditors, and their predators, including divorced spouses. Another advantage to making gifts in trust is that the assets in the trust at the children's deaths can (within limits) pass estate-tax free to the business owner's grandchildren through a generation-skipping or dynasty trust. Setting up a family trust can help simplify complex family needs and responsibilities and removes the family from day-to-day business operations while retaining their voting rights as stockholders.

5) *Gift to Charity and Corporate Repurchase*: Business owners who are charitably inclined can gift some shares to children and the remaining balance to charity. Several months later, the corporation can then redeem them by repurchasing the charity's shares, leaving the charity with liquid assets and the children as the sole shareholders of the corporation. As long as the charity is a public charity, the redemption of the charity's shares may be achieved with either cash or a note. The reason for doing this is to reduce the number of shares that will eventually need to be transferred to the active children. This strategy saves income, gift, and future estate taxes. The business owner receives a current charitable income tax deduction, avoids capital gains taxes, and reduces his/ her gift and estate taxes. It is important that there be no prearranged agreement that the charity's shares will be redeemed. Specifically, on the date of the gift to the charity, neither the corporation nor the charity may be bound to affect a redemption. However, a mere understanding concerning the sale of the stock is permitted under Rev. Rul. 78-197, 1978-1 C.B. 83, provided the "understanding" is not legally binding.

## Sales with Minimal Taxes

If it is known that the company cannot bypass the imposed taxes that will in effect "shut the doors of the business" through gifting it, they may decide that the best strategy is to sale the business to the successor. Grassi and Giarmarco also give several sales strategies that provide a way for the predecessor to sale the business to the successor at a minimal tax loss.

1) *Installment Sales*: This is an excellent way to provide a steady stream of cash flow (and retirement income) to the business owner while transitioning ownership of the business to the active children. The installment sale must bear interest at no less than the applicable federal rate published monthly by the IRS. If the purchase price is less than the fair market value of the shares, the business owner can deem that they have made a gift to the purchaser.

2) *Private Annuities*: With a private annuity, the business owner (the annuitant) sells the business interest to the active children (the purchasers) for an unsecured promise to make periodic payments to the annuitant for the remainder of the annuitant's life (a single life annuity) or for the remainder of the lives of the annuitant and their spouse (a joint-and-survivor annuity). The size of the annuity payments depends on the business owner's life expectancy. Since the payments terminate upon the business owner's death, neither the business interest nor the annuity is included in the business owner's estate for estate tax purposes. Because the private annuity is a sale and not a gift, it allows the business owner to remove the business interest (and the future income and appreciation thereon) from their estate without incurring gift or estate tax. The business owner must recognize any capital gains in the year of sale. Thereafter, each annuity payment in excess of the seller's ratable basis is taxed as ordinary income. The annuity cannot be secured and the purchaser cannot deduct any portion of the payments. When there would be little or no capital gains recognition by the seller, a private annuity is an excellent vehicle for a business owner who wants to sell their business during their lifetime and receive income until they die. Of course, there is always the possibility that the business owner will outlive his/her life expectancy, in which case the children purchasing the business will pay more than expected. Private annuities can be particularly helpful from an estate tax perspective when the business owner is in poor health and not likely to live out his/her life expectancy. The business owner could sell the business to the active children who would only make payments until the owner's death. Thus, the children could pay very little for the business. However, to rely on the IRS's actuarial tables to determine the amount of the annuity (as opposed to the owner's actual life expectancy), the business owner must have a 50 percent chance of living one year beyond the private annuity agreement. If the business owner lives for at least 18 months beyond the private annuity agreement, there is generally no challenge by the IRS. In any event, a medical assessment to document the business owner's health condition should be obtained when entering into a private annuity arrangement.

3) *Self-Canceling Installment Notes*: When a business owner decides to sell their business to a child on an installment basis, the promissory note may be a self-canceling installment note (SCIN). With a SCIN, upon the seller's death, all remaining payments under the note are canceled, similar to a private annuity. The purchaser must, however,

pay a premium for this cancellation feature in the form of either a higher interest rate or a larger purchase price. Like a private annuity, a SCIN avoids estate and gift taxes. However, unlike a private annuity (which results in the seller's immediate recognition of gain), gain under a SCIN is recognized by the seller as payments are received. However, when the seller dies, any unrecognized (i.e., cancelled) gain at the seller's death under the SCIN is reportable either on the seller's final IRS form 1040 or on the seller's estate's IRC form 1041.

The factors that need to be considered when determining which techniques to use include the size of the predecessors' taxable estate, their need for retirement income, and their desires to control the business during the succession period. Federal and state inheritance taxes can be substantial, and survivors all too often are forced to liquidate the family business to meet such tax obligations. Accountants and lawyers who specialize in business succession planning can provide invaluable advice about these tax strategies. After spending a lifetime developing a company, a founder doesn't want their retirement or death to be the cause of its demise!

## Conclusion

The key take away from the previous content is that succession planning is complex and an integrated system that requires patience and sincerity in communications. The issues dealt with are not always comfortably communicated about, but with the value and vigor in a family they can be conquered. The first thing the owner must do is obtain a life insurance policy that will provide enough economic benefits to keep the business running in the event of their incapacitation/death. Then it is very beneficial to construct an advisory board to help begin the process of creating the actual succession plan. The owner must recognize and communicate their personal goals, objectives and financial needs so that the successor(s) and advisory board understand what direction to take the plan in. When communicating these ideas, they must be realistic and attainable or the entire plan can be invalid. The next two steps are some of the most difficult to deal with, but are the crucial points of the entire plan. Deciding who will manage and own the business entity is a daunting but critical stage to help reach the summit point of a well-built robust plan. It has been stated numerous times in this paper that the two are not one in the same. They are completely different issues and should be handled as such. Management can be left to multiple children or key employees while the ownership is succeeded to others. When choosing who will manage the company, the predecessor should take all merits into account and leave it to the most deserving and best suited successor. Ownership, on the other hand; should be dealt with vigilantly. An owner does not want to create more issues inside of a family then life already presents. Therefore, it needs to be in writing and agreed upon by the family as to how the ownership will be devised and dealt with appropriately.

As a side bar note; one of the best ways to get the talks of management and ownership going, families should consider times when they are all truly together and in good spirits. A great time for these communications is during the holidays. Usually, families have an arrangement and plan created so that all married and children that have left the homestead share the same holidays with their family. Meaning that they may only get together once or twice a year, but they are all together and normally in good spirits because of the holiday. Once everyone is gathered around, simple communications about each others goals and plans in life can be a great conversation starter. One cannot say what the best approach for an individual family is, but mere

communication on these issues will have every member buzzing about what the futures hold. If for no other reason; the family will want to discuss these issues because there is a very small percentage of human beings that will not be excited over the chance to get richer. A vital aspect is to face the morbid discussion of death. Every human understand that they will be deceased at some time; therefore don't be ashamed or scared to bring about this conversation early. By clearing the air of this sinister topic, the rest of the plan can be worked on with a greater since of relaxation. Keep in mind that the interaction still has to be kept sensitive, but must be addressed. A last pointer during these two stages is to bear in mind that bringing about succession talks during times of extreme stress is not a good idea. The negating moods from the stress could lead to battles amongst the family that are not personal attacks but merely stress fracturing the simple mind frame of good individuals. During such times as funerals, weddings, child birth and/or any other periods of high stress amongst the family; one should refrain from starting the succession plan talks. This does not mean the talks should be avoided, but yet one should wait for the correct moment after the tension of the apprehensive affair has subdued.

The last stage is very critical to the business, but not as critical to the family life. The tax component of this paper is outlined merely to help gain a perspective of what needs to be done. The best advice from the fifth stage is to consult a personal financial planner, estate management team, and an attorney to help create a strategy to minimize the tax effects of the succession. This stage will normally not create large problems for the family away from the business, but should be given the utmost importance. Mainly because it holds great economic impacts on the business and should be dealt with so that the business may remain in operations after the succession plan has been implemented.

Business succession planning is critical to ensuring the continuation of any family owned business, particularly if the owner plans to retire in ten years or less. An effectively developed succession plan provides for a smooth transition in management and ownership with a minimum of transfer taxes. Additionally, a business succession plan can provide financial security and freedom to the retired business owner and their spouse. Given the number and complexity of transition and succession options available, effective business succession planning requires time, the assistance of outside advisors, the input of family members (especially the owner and the owner's spouse concerning their goals), and the willingness to address interpersonal conflicts that can arise during the planning process. Once completed, the business succession plan will provide peace of mind for the business owner and key employees, personal satisfaction for family members, and new opportunities for the business itself.

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# SMALL BUSINESSES AND THE OLDER WORKER

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## Abstract

As the U.S. workforce continues to age, older workers will present unique challenges and opportunities to small business owners. In many instances, small business owners will have to rely on their older workers' expertise and experience. Although many myths exist about older workers, they are both productive and reliable. While they provide significant value to small business owners, they present both drawbacks and positives to the workforce as is true of all generations. With the increase in the number of older workers has come an increase in age discrimination lawsuits that will prompt both the courts and Congress to address the current law. Given the uncertain state of employment discrimination law, the paper presents guidelines to small businesses to enhance the contribution of these employees and simultaneously avoid lawsuits.

## Introduction

The U.S. workforce is growing older. This demographic shift provides some unique opportunities to small business owners to fully utilize their older workers. Small business owners will have to acknowledge their strengths and weaknesses, overcome stereotypes about older workers, and meet some of their special needs.

## Age Data: The Older Worker

What does the term "older worker" mean exactly? The Age Discrimination in Employment Act (ADEA) defines an older worker as anyone over the age of 40 (29 U.S.C.A. sections 621, 1967). Chronological age has been the most common method to classify individuals as older. Historically this was set at the age of 65 which was considered retirement age (Sheppard & Rix, 1977).

This number dates back to the year 1916 when Germany set it as the official retirement age (Strenger & Ruttenberg, 2008). This was based on a 49 year life expectancy making 65 seem "older" (Strenger & Ruttenberg, 2008). During the 20$^{th}$ century in the U.S. the retirement age was considered to be 70 (Alley & Crimmins, 2007).

## The Demographic Shift

This demographic shift is readily apparent. The baby boomer generation has 76 million individuals born between 1946 and 1964 (Matarazzo and Mika, 2006). In contrast the next generation, Generation X, has 46 million individuals. Current estimates place the older workers at 20% of the workforce by 2015 which would be an increase of nearly 50% through the year 2014 (Montgomery, Borgatta & Kosloski, 1990). This generation is the fastest growing age group in the workforce (Strack, Baier & Fahlander, 2008).

## Underlying Factors in the Demographic Shift

There are several factors accounting for this demographic change. First life expectancy in the US has shifted to around 80 years of age (Strenger & Ruttenberg, 2008). Medical advances allow many of these individual to achieve a higher quality of life than previous generations. Just because individuals reach 65 years of age does not automatically mean that they will leave the workforce (Salopek, 2007). With better health, many want to stay active and engaged.

## Age Stereotypes and Age Bias

Age bias is a very complex term and can include age stereotype, discrimination, prejudice, and ageist attitudes " (Finkelsein & Farrell, 2007). For example an age stereotype is an attitude, opinion, expectation or belief that categorizes an individual into a certain group of people such as "older."

There is a stereotype that older workers are: resistant to change, slow to make decisions, and resistant to technology and less ambitious. Some people view them as having low creativity and lower physical ability (Finkelstein & Farrell, 2007). Another stereotype views them as cranky, ineffectual, and unwilling to learn new things (Finkelstein & Farrell, 2007). These stereotypes are summarized in old sayings like "Over the hill" or that, "You cannot teach old dog new tricks" (Strepp, 1990, p. 5).

## Medical Effects of Aging

As we age there is a decline in some physical abilities and some possible productivity effects (Hale, 1990). The ageing process can bring medical issues requiring sick leave and health care issues (Hale, 1990). Health issues and early retirement do affect the number of such individuals in the workforce ( Montgomery, Borgatta & Kosloski, 1990, p. 21). They do have a higher risk of illness, infection, and sometimes suffer from the effects of disease and lower immunity (McMahan & Sturz, 2006). Some individuals may experience losses of: vision, hearing, memory, breathing capacity, and stamina. The results can include: ill health from terminal illnesses, weakened immune weakness, unhealthy nervous systems, and other general inefficiencies of the human body (McMahan & Sturz, 2006; Hale, 1990).

However these effects are entirely individualistic. Productivity declines in older age groups depend on each individual and are not generalizeable to an entire group (Hale, 1990). Hale (1990) also found that 75% of older adults are healthy enough to maintain themselves and take part in normal daily activities including work.

## Drawbacks of Employing Older Workers

The above indicates that older workers can sometimes have health issues which can create absences or vacancies. Hale (1990) cites other drawbacks including: long term vacancy issues, potential attitude issues, lack of desire or ability to work long hours, and overall fatigue and depression.

Hale's (1990) research's also notes that sometimes older workers are resistance to change and training. (Other researchers found the opposite, that they are amenable to new ideas and training (McMahan & Sturz, 2006)).

## Positives of Older Workers

On a positive side Hale (1990) notes that older workers bring the following: lower turnover rates, more loyalty, higher quality of work, strong work ethics, belief in the intrinsic value of work, and belief in the intrinsic value of their work. They are capable of achieving a good work life balance, are not focused just on monetary gain, can take risks, can assume managerial tasks, and want to bring value to their employers (Hale, 1990).

McMahon and Sturz (2006) believe that older workers are more loyal, actually take fewer sick days, have fewer injuries, and are willing and capable trainees. They argue that older works are very capable and therefore valuable to their employers.

## Small Business Owners/Managers Need for Older Workers

The issue of whether or not older workers embrace new technology and training is an important one. The Small Business Administration's Report to the President 2008 noted that small businesses provide a large portion of the U.S. training (Small Business Administration's Report to the President, 2008). In order for older workers to stay engaged and pass on their knowledge they will have to both receive training and be part of the training of successive generations. Salopek (2007) believes that not only are older workers trainable but are eager and willing to both train and mentor their younger protégés. If the U.S. desires to remain competitive in the world marketplace they cannot ignore the abilities of this group.

## Legal Issues Involving Older Workers

As the number of older workers has increased so have age discrimination lawsuits and the dollars awarded. The number of EEOC's age discrimination cases increased from 15,785 in 1998 to 24,582 in 2008 an increase of 62%. In the same time period the amounts of the awards increased from 44.3 million dollars to 82.8 million, an increase of 87% (EEOC, Age Discrimination in Employment Charges, 2009). A recent Supreme Court case attempted to clarify age discrimination law but created a powerful incentive for Congress to intervene. Older workers have political power and can be expected to appeal to Congress to change the court's direction which it did with the Civil Rights Act of 1991 (29 U.S.C. A. sections 2000e).
The following sections explain current age discrimination law, the two types of legal theories that are used and the recent Supreme Court case that affected both legal theories.

## Background and Coverage of the Act

In the preamble to the Age Discrimination Act (ADEA), Congress argued that older workers have higher unemployment rates and are disadvantaged in obtaining and retaining employment. It disapproved of arbitrary age limits that do not consider an individual's performance (Age Discrimination in Employment, 29 USCA Sec 621, 1967).

The ADEA disallows employers from discriminating, limiting, classifying, or segregating employees on the basis of their age. Like Title VII of the Civil Rights Act the law covers compensation, terms, conditions, or privileges of employment. This has been interpreted to mean anything that happens to the employee at work which would include but is not limited to: recruitment, selection, promotion, training, orientation, performance appraisals, retention, discharge and benefits including retirement plans. Therefore almost any action by a small business owner/manager that affects the business's workforce is covered by the ADEA.

The law covers all employers in interstate commerce with twenty or more employees. The Small Business Administration's definition of small business includes some employers with as many as 500 employees, therefore the law covers all but very small employers (Small Business Administration, 2009). In addition, many states have similar age discrimination statutes with different levels of employees. An example is Colorado's civil rights laws which include employers with one employee (Colorado Civil Rights Act, 2008).

Because the ADEA is a federal law it is based on the Constitution's interstate commerce clause and only applies to small employers in interstate commerce. However, the courts have consistently ruled that most U.S. businesses in today's global and interconnected economy are either affected or contribute to the interstate economy. Consequently, only the very small and completely local small businesses that do not serve the public or customers in other states are exempt.

## Applicable Employment Discrimination Theories

There are two distinct theories of employment discrimination: disparate treatment and disparate impact. The following explains that the former is very limited and based on individual circumstances while the latter is much broader and can include groups such as class action lawsuits. The Supreme Court narrowed the former and eliminated the latter. The case and its implications are explained and a perspective on why Congress will probably intervene is presented.

## The Theory of Disparate Treatment

This theory has been used extensively since the Supreme Court decision in McDonnel Douglas v. Green (U.S. Supreme Court, 1971). In this case, Green was a black union activist who had worked at his job for a number of years with high proficiency. Green was involved in various union activities including a park-in where the union blocked access to the employer's parking lot. When the company lost a government contract, it laid off Green and many other workers. When the company's finances improved, they started advertising and rehiring. Green applied for his old job, was denied, and the company continued recruiting with the eventual selection of other workers. Green was able to show that there was a job available, he was qualified for placement, and the company did not hire him, continued to search, and hired other employees. The Supreme Court's McDonell Douglas case created the three part analysis of disparate treatment. The plaintiff must prove the following: 1) that they are a member of the protected class- over 40 years of age, 2) that there was a job available, and 3) the plaintiff was qualified for the job. The company must then articulate a legitimate, non-discriminatory explanation for the employment decision. The court then determines if the reason is satisfactory or if it is a pretext hiding age discrimination.

The doctrine is very narrow for three reasons. First the theory looks at an individual's situation not a group's so it infrequently uses a group or class action lawsuit like disparate impact. Second, the plaintiff must be able to prove that he/she was qualified for the job. Therefore most cases depend on the adequacy of the employer's stated reason which could be actual or developed after the employment decision.

Because this theory is based on individual claims, the size and potential employer liability are much smaller. The plaintiff bears the burden of proof and is confronted by employers who usually have more resources for lawsuits.

## Disparate Treatment and Mixed Motives

The Supreme Court ruling in Price Waterhouse v. Hopkins added to the disparate treatment theory (Price Waterhouse v. Hopkins 490 U.S. 228). If a company commingled both discriminatory and non discriminatory motivations, it had to show that it would have reached the same decision absent the discriminatory reasons. The plaintiff, a CPA seeking partnership status, argued that the company discriminated against her because of her gender. Some partners had made comments about her femininity. Conversely, the company offered proof alleging her performance deficiencies.

## Disparate Impact

The theory of disparate impact was developed in Griggs v. Duke Power, Company (Griggs v. Duke Power, 401 U.S. 424, 1971).The employer had historically discriminated against blacks resulting in segregation of most of the black employees into lower paying outside jobs. Conversely, most of the whites worked at higher paying inside jobs. After the Civil Rights became effective, the company instituted two tests and the requirement of a high school diploma as criteria for any inside jobs. Using statistical evidence, Griggs showed that fewer blacks in the South at that time had high school diplomas. In addition, some of the whites had never taken either of the two tests and were performing their jobs proficiently.

The Court ruled that Congress intended to remove artificial barriers to employment, tests had to be validated, and any practice - even if neutral on its face - was illegal if it had a discriminatory impact on a protected group. The company carried the burden of proof to show that its practice was job related, a business necessity, and that no alternative practice existed that would discriminate less (Griggs, v. Duke Power, 1971).

Since 1971 numerous cases have further developed the theory. This expansion continued until the Supreme Court in Wards Cove v. Antonio attempted to limit this development (490 U.S. 642, 1989). The fact situation in Wards Cover mirrored that of Duke Power's where the company had segregated many Filipino workers into lower paying and dirtier jobs in the fish cannery while most of the higher paid and inside workers were white. The ruling limited disparate impact and placed the burden of proof on the plaintiffs ( 490 U.S. 642, 1989). Dissatisfied with the ruling, Congress put the theory of disparate impact with its concepts of business necessity, and job relatedness into Title VII by passing the Civil Rights Act of 1991(29 U.S.C. 2000e-2(k), 2000).

Currently, the theory of disparate impact allows the use of statistical evidence to show that there is a disproportionate impact on a protected group by the employer's practice. It allows for group or class action lawsuits in which an individual or group can sue claiming that others were similarly treated by the employer. The concept can affect actions by the employer that were unintentional or even accidental as long as a group was affected. Therefore, the size of the lawsuits and the size of the employer's liability are much greater in disparate impact cases.

## The Current Supreme Court Case: Gross v. FLB

The US Supreme Court in a recent 2009 case attempted to clarify some of the issues in the ADEA. In this case, it disallowed use of the disparate impact argument in ADEA cases and severely limited plaintiff's ability to win disparate treatment cases. This case has the potential to motivate Congress to place Supreme Court decisions of disparate impact into the ADEA like it did to the Civil Rights Act. The number of older workers is increasing and with it their economic and political influence.

In Gross v. FBL Financial Services, Inc (129 S. Ct. 2342, June 18, 2009), Gross filed suit alleging that his employer demoted him and violated the ADEA. He had worked at FBL since 19771 in the position of claims administration director and was then at the age of 54. The employer reassigned some of his job duties to a younger woman (in her forties) who he had previously trained and renamed his position as claims administration coordinator.

Although both individuals received the same compensation, Gross considered the reassignment and renaming a demotion and an age violation. FBL defended its actions by arguing that his reassignment was part of a corporate restructuring and that the position was better suited to his skills.

The District Court instructed the jury to return a verdict to Gross if he had proved by a "preponderance of the evidence" that FBL demoted him to claims project coordinator and that his "age was a motivating factor." Gross's age would provide a motivating factor if it played a part or a role in FBL's decision to demote him. Conversely, the jury was instructed to find for FBL if it had proven by a preponderance of the evidence that FBL would have demoted him regardless of his age. The jury returned a verdict for Gross and awarded him $46,945 in lost wages.

## The Supreme Court Ruling in Gross

The Court ruled that the ADEA and Title VII were different laws and that the theory of disparate impact developed under Title VII could not be used in Age Discrimination cases (Gross v. FBL, 2009). The court argued that Congress could have amended the ADEA when it amended Title VII and did not. It also disallowed the mixed motive argument. However, the biggest change requires future plaintiffs to prove with a preponderance of the evidence that age discrimination was the "but-for" cause of the employer's action. Thus the burden of proof does not shift to the employer to show that they would have reached the decision absent age as a motivator.

## The Current State of Age Discrimination Law after Gross

There are several impacts of this decision. First, restricting age discrimination cases to disparate treatment removes the use of statistical evidence and group or class action claims. The proof must center on that individual's situation. The disallowance of mixed motives arguments strengthens the company's position while limiting the plaintiff's. The latter bears almost the total burden of proof. Even if the plaintiff provides some evidence that age was a factor they must additionally prove that the employer almost totally relied on age – the but-for" factor.

Because this is a current case, no case law exists that clarifies what level of proof meets this but-for level. At the extreme a plaintiff would have to find and provide evidence that an unaware supervisor or small business owner made the mistake of saying age was the reason verbally, in company documents, or company emails. As soon as small business owners are made aware of the decision, the prudent ones will be careful to avoid any comments by themselves or their managers in any form. This includes communication that is verbal or written in company documents, emails, text messages and others. If asked, employers would only have to articulate a seemingly rational reason even if it came after the fact. Therefore, it is doubtful that many age discrimination plaintiffs will succeed.

## Guidelines for Employers

Small business owners and managers can take the following simple steps to ensure that they do not violate the Age Discrimination in Employment Act:

- ✓ Perform a job analysis on every job in the company to put into company records the requirements including job descriptions and job specifications.
- ✓ Perform a complete orientation of each new hire to ensure that they know the above.
- ✓ Do regular performance appraisals which are documented and shared with the employee.
- ✓ Never verbally or in any company computer system, email system, voice system or other any comment about any employee's age.
- ✓ Base discipline and discharge on documented employee performance. All company communications either verbal or written would be limited to this documentation.

## The Future of Age Discrimination Claims

The future is definitely uncertain. There is a large body of court cases on disparate impact and disparate treatment. Corbett (2009) argues that these number of court cases have left employment law unwieldy and unclear and believes that Congress should amend both Title VII and the ADEA.

## The Future Relationship of Older Workers and Their Small Business Owners

The demographic shift resulting in older workers in the workforce is very pronounced. This presents some opportunities and issues to small business owners. While age does create some physical issues for some older workers, the above research shows that many are very loyal and capable employees. As time progresses, small business have the opportunity to tap into their expertise and use them to fill the labor shortage while they train and mentor the succeeding generations.

Conversely they do have some special needs as does any of the current generations. As the aging process continues some may need flexible time to take care of health and other issues. Others may need to have some health care insurance coverage.

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# FAMILY-MEMBER AND NON-FAMILY-MEMBER MANAGERS IN FAMILY FIRMS: ADDING A SEVENTH COUNTRY TO THE INTERNATIONAL DATABASE - KOSOVO

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## Abstract

Extending earlier analyses of the authors in other countries with regard to the inclusion of family-member managers and non-family-member managers in family businesses, and the relationship of this variable to certain management activities, styles and characteristics, this current study analyzes data from Kosovo. Results of statistical testing indicate almost no changes in management attributes as the proportion of non-family-member managers increases in family firms. Implications for practitioners, consultants and researchers are presented.

## Introduction

The purpose of this study was to investigate family businesses with regard to the degree to which such firms employ non-family members as managers. How does the percentage of non-family-member managers to family-member managers in a family firm relate to various managerial activities, styles and practices of that firm? Recent studies by the authors in other countries were replicated in Kosovo, so as to expand the total data base and to strengthen the total set of findings.

Prior research into the issue of family-member managers (FM's) versus non-family-member managers (NFM's) in family businesses has been limited. Chua, Chrisman and Sharma, with very strong empirical experience in the field of family business, concluded that "issues related to non-family managers [in family firms] have received very little attention by researchers" and "there is definitely a gap in our understanding of the role played by non-family managers in the family business" (2003, pp. 102, 103). Chrisman, Chua, and Sharma (2005) stated that many questions remain unanswered and much interesting research remains to be done to determine how family involvement affects firm performance. Ensley and Pearson (2005) concluded that family business research needs to identify the nature of family involvement in top management teams, in response to which Nordqvist (2005) agreed that this is a breach in the literature that has not received much attention. Chrisman, Chua, and Steier also agreed with the need to better understand top management teams in family businesses as "this is a topic of great importance since the decisions of top mangers may determine the extent to which a family business obtains distinctive familiness and superior economic performance" (2005, p. 241).

There is also a growing interest in investigating management characteristics and activities in different countries. Oviatt and McDougall (2005) called analyzing entrepreneurial behavior in various countries rich in opportunities and having possibilities to move such research from its infancy into high growth.

This current study is therefore important in that it brings new empirical research to these issues of FMs and NFMs in family business management, and that it does so in a country not previous studied with regard to this issue.. Furthermore, the results of this research are not only of value to researchers, but should also be of value to consultants to family businesses and to family business owner/managers themselves, both of whom may gain insight into the possible impact of having non-family managers in family businesses.

## Literature Review

Although most definitions of a "family business" include the criterion of the prevalence of family members in the management team, an extensive review of the family business literature has found few academic papers or journal articles that investigated the impact of NFM's on the management activities, styles and practices of family firms. The papers and articles that did touch on this topic usually did so in a tangential manner and/or in a conceptual or anecdotal method, rather than via empirical investigation. Somewhat more frequently found, but still few in number, were papers and articles that compared family businesses and non-family businesses, an issue quite different in nature. Still another related but again a different issue is the use of non-family-members on the corporate or advisory *boards* (but not in the *management*) of family firms, a topic occasionally investigated and the (largely anecdotal and conceptual) focus of an entire issue in the first year of publication of the *Family Business Review* (1988 v.1 n.3).

Still, some prior studies did indeed investigate FM's and NFM's in family firms. Several analyses have focused on the issue of how a family firm CEO should adapt to working with non-family managers, and the difficulty of delegating managerial responsibilities to non-family-members (Firnstahl, 1986; Goffe & Scasse, 1985; Hofer & Charan, 1984; Mathews 1984; Perrigo, 1975). The reverse issue - how to facilitate the adaptation by the non-family-manager to the family firm's culture and goals - was considered by Dyer (1989) and by Mitchell, Morse and Sharma (2003), who pointed out that NFM's must adapt to the family firm and need assistance in doing so.

Other investigations regarding FM's and NFM's focused on compensation for NFM's (McConaughy, 2000; Poza, Alfred & Maheshawi, 1997), and on retention of NFM's (Ward, 1997). And Gallo and Vilaseca (1996) and Dorgan, Dowdy and Rippin (2006) looked at the possible performance benefits of family firms with NFM's versus those without.

A study by Chua, Chrisman and Sharma (2003) emphasized the relevance of Agency Theory in explaining and understanding the relationship between FM's and NFM's in family firms. They empirically investigated the percentage of NFM's in the management team of a family firm and its relationship to the FM's concerns about their relationships with NFM's. Among their conclusions was that past assumptions of zero or low agency costs in family firms require further thinking, as these costs are more complex and asymmetric than previous supposed.

Yet another group of (largely anecdotal and conceptual) studies relate the advantages and disadvantages of family-members versus nonfamily-members as managers of family firms. Some studies see positive benefits of FM's, such as extra-ordinary commitment (Donnelly, 1964; Horton, 1986), more warm, friendly and intimate relationships within the management team (Horton, 1986; Staff, 1981), the potential for deep firm-specific tacit knowledge, often based on early involvement in the firm (Lane & Lubatkin, 1998), governance advantages (Carney, 2005), and the creation of a synergy in the top management team due to higher cohesion, potency, and

positive task conflict (Ensley & Pearson, 2005). Marcus and Hall (1992) see a preponderance of FM's as benefiting the firm's service providers, and Goody (1996) concludes that such preponderance facilitates firm growth as members of succeeding family generations are available to open new branches of the company.

However, some other studies see a downside to a firm's managers being members of the same family. Limiting management positions primarily to family members may lead to hiring sub-optimal people who can not be easily dismissed (Dunn, 1995; Whyte, 1996), and can lead to greater conflict because of non-merit-based promotion criteria (Leyton, 1970: Wong, 1988). Also, qualified nonfamily managers may avoid family firms where their potential for growth, promotion and remuneration is hampered (Covin, 1994a; Covin, 1994b; Donnelly, 1964; Fiegener et. al., 1996; Horton; 1986; Stewart, 2003). And Dhaliwal (1998) and Song (1999) note that in many cultures, kinship criteria in choosing managers reduce the managerial opportunities and role for female members of the family.

Another group of studies investigate the negative impact of NFM's in family firms. Several researchers conclude that the presence of NFM's can result in "creative destruction" when NFM's create too much firm growth and thus weaken family managerial and/or financial control (Morck & Yeung, 2003; Morck, Strangeland & Yeung, 2000; Olson, 1963, 1982, 2000). And the fear of such "creative destruction" may in turn lead to FM's blocking or discouraging NFMs' creativity and innovation and thus stifle desirable company growth. Other studies have found that a mixture of FM's and NFM's in the same firm may lead to greater conflict within the managerial team (Schultz et. al., 2001, 2003).

Therefore, because there are both positive and negative conclusions about the inclusion of NFM's in family firms, several writers focus on the need to socialize new NFM's, clearly communicate to them existing family values and objectives, and tie the interests of the NFM's to the firm, for example via stock ownership and board membership (Astrachan & Kolenko, 1994; Berenbeim, 1990; Dyer, 1989; Gubitta and Gianecchino, 2002; Sirmon & Hitt, 2003).

Finally, some family business researchers have focused on developmental issues or the stages of evolution of family business growth. Gersick et. al. (1997) presents a four-stage model of family firm development, and Peiser and Wooten (1983) focus on the life-cycle changes in family businesses. As family firms grow, these writers see a likelihood of bringing greater numbers of nonfamily managers into the company. Thus, the body of literature specifically relating to FM's and NFM's in family firms provides limited empirical evidence and little consensus or clear conclusions.

## Hypotheses

As explained above, the objective of this study was to investigate family businesses with regard to the degree to which such firms employ non-family-members as managers. How does the percentage of non-family-member managers to family-member managers in a family firm relate to the managerial activities, styles and practices of that firm? The hypotheses used for this current study are based on the hypotheses used in previous studies by Sonfield and Lussier (2004, 2005a, 2005b) of family firm management activities, styles and practices, which in turn derived from findings and propositions developed by earlier researchers who investigated family firms. Due to the limited prior empirical research with this specific FM vs. NFM focus, and the exploratory nature of this current research project, a large number of hypotheses involving a wide variety of family business issues have been chosen for testing, rather than focusing on a

few specific managerial issues. Thus the significance of the various hypothesis test results may indicate that some factors are more worthy of further research and analysis than are others.

The prior research from which these hypotheses are derived generally did not specifically focus on FM's versus NFMs. Rather, these *various* research studies dealt with other aspects of family firm *growth* – measured in particular by *generations*, and also by *age*, *size*, or *stages*. Because family firm growth may sometimes be accompanied by a rising proportion of NFMs, these studies were used to identify family business variables worthy of investigation in this current study but not to generate specific hypotheses of relationships between the proportion of NFMs and management attributes. For this reason, and because there are minimal and mixed prior findings with regard to FM's and NFM's in family firms, *the null hypothesis is used throughout.* The following paragraphs briefly provide the bases for each hypothesis.

Nelton (1998) investigated gender issues in family firms and concluded that daughters and wives are rising to leadership positions in family firms more frequently than in the past, and that the occurrence of daughters taking over businesses in traditionally male-dominated industries is increasing rapidly. Focusing on societal trends rather than family firm generational issues, Cole (1997) found the number of women in family businesses increasing. More generally, U.S. Census Bureau data showed women-owned firms growing more rapidly than those owned by men (Office of Advocacy, 2001). While this is an important variable for family businesses, no prior studies have linked this issue to the variable of FMs versus NFMs. Thus:

H1: The percentage of non-family-member managers in a family firm will not have a significant relationship to the percentage of women family members involved in the operations of the firm.

The distribution of decision-making authority in the firm is another aspect of family business behavior. Dyer (1988) found decision-making to be more centralized in first-generation family firms than in subsequent-generation family firms. Aronoff (1998) developed this suggestion further and postulated that subsequent-generation family firms are more likely to engage in team management, with parents, children and siblings in the firm all having equality and participative involvement in important decision-making, even if one family member is still the nominal leader of the business. Thus:

H2: The percentage of non-family-member managers in a family firm will not have a significant relationship to the use of a "team-management" style of management.

Interpersonal dynamics, including conflict and disagreement among family members, has been a major focus of family firm research (Kellermann & Eddleston, 2004). Conflict can exist in younger, first-generation family firms, when siblings, spouses or other relatives participate in management and/or ownership, and conflict can also arise between members of different generations in older, subsequent-generation family firms. Beckhard and Dyer (1983) found that conflict among family members increases with the age of the firm and the number of generations involved. Conversely, Davis and Harveston (1999, 2001) concluded that family member conflict increased only moderately as firms grew and moved into the second-generation stage, but there was a more sizable increase in further growth from second to third-generation. Thus:

H3: The percentage of non-family-member managers in a family firm will not have a significant relationship to the occurrence of conflict and disagreement among family members.

Another major focus of the literature on family firms has been succession. The primary issues here involve the difficulties founders have in "letting go" and passing on the reins of control and authority, the lack of preparation for leadership next-generation family members often receive, and thus the need for, and importance of, succession planning (Davis, 1983; Handler, 1994; Upton & Heck, 1997). Dyer (1988) investigated "culture and continuity" in family firms, and the need for firm founders to understand the effects of a firm's culture and that culture can either constrain or facilitate successful family succession. Fiegener and Prince (1994) compared successor planning and development in family and non-family firms, and found that family firms favor more personal relationship-oriented forms of successor development, while non-family firms utilize more formal and task-oriented methods. Building upon these and other studies of succession in family firms, Stavrou (1998) developed a conceptual model to explain how next-generation family members are chosen for successor management positions. This model involves four factors which define the context for succession: *family*, *business*, *personal* and *market*.

Some of the earlier family business studies have dealt with various aspects of succession, but none have specifically investigated succession planning and practices in relationship to FMs versus NFMs. Still, given that the importance of succession has been well established and publicized, and that family firms often experience the trials of succession as they grow, there may be a relationship between the proportion of NFMs and succession planning. Thus:

H4: The percentage of non-family-member managers in a family firm will not have a significant relationship to the formulation of specific succession plans.

A number of earlier researchers of family firms have postulated that, as these firms grow, they also progress from one style of management to another. Informal, subjective and paternalistic styles of leadership become more formal, objective and "professional" (Aronoff, 1998; Cole & Wolken, 1995; Coleman & Carsky, 1999; Dyer, 1988; Filbeck & Lee, 2000; McConaughy & Phillips, 1999; Miller, McLeod & Oh, 2001; Schein, 1983).

"Professional" management may involve the following: (a) the use of outside consultants, advisors and professional services, (b) more time engaged in *strategic* management activities, and (c) the use of more sophisticated financial management tools. These conclusions lead to three hypotheses:

H5: The percentage of non-family-member managers in a family firm will not have a significant relationship to the use of outside consultants, advisors and professional services.

H6: The percentage of non-family-member managers in a family firm will not have a significant relationship to time spent engaged in strategic management activities.

H7: The percentage of non-family-member managers in a family firm will not have a significant relationship to the use of sophisticated methods of financial management.

Still another issue of interest in the investigation of family business is "generational shadow" (Davis & Harveston, 1999). In a multi-generation family firm a generational shadow, shed by the founder, may be cast over the organization and the critical processes within it. In such a situation, "succession" is considered incomplete, may constrain successors, and may have dysfunctional effects on the performance of the firm. Yet this "shadow" may also have positive impact, by providing a clear set of values, direction and standards for subsequent firm managers. Kelly et al. (2000) similarly proposed that a family firm founder's "legacy centrality" will influence the strategic behavior of succeeding generations' family member managers, with both positive and negative impact. Davis and Harveston (1999) also investigated generational shadow, but reached mixed conclusions regarding its impacts. If "generational shadow" and "legacy centrality" are valid components of the family business system, then it is of value to investigate whether the increased presence of MFMs will related to stronger or weaker "generational shadow" or "legacy centrality." Thus:

H8: The percentage of non-family-member managers in a family firm will not have a significant relationship to the degree of influence by the original business objectives and methods of the founder.

Although most family firms are privately owned, some are not. As family firms grow, opportunities and needs for "going public" may arise. The family may not be able, or may not choose, to provide sufficient management or financial resources for growth, and outsider ownership can resolve this situation. And even publicly owned companies can continue as "family businesses," if management or financial control is maintained by the family. In the United States, McConaughy (1994) found that 20 percent of the *Business Week 1000* firms are family-controlled, while Weber and Lavelle (2003) report that one-third of *S & P 500* companies have founding families involved in management. Thus:

H9: The percentage of non-family-member managers in a family firm will not have a significant relationship to management's consideration of "going public."

## Methodology

*Country Selection*

*The opportunity to collect data in Kosovo provided continued expansion of the authors' data base of family businesses. Earlier analyses of family businesses have been conducted in Croatia, Egypt, France, India, Kuwait, and the United States.

The Republic of Kosovo, with a population of about 2 million, is located in the center of the Balkan Peninsula. Kosovo is a new country which is in the early stages of creating a market driven economy with minimal intervention from the government. Kosovo imports mostly come from Macedonia and Serbia, as well as from other European countries.

Kosovo's GDP in 2008 was 3.8 billion Euros, just above 1,800 Euros per capita, the lowest in the Balkans. Kosovo's economy relies heavily in remittances from abroad, which represent up to 15% of the GDP, as well as foreign direct investments. Kosovo is one of the poorest countries in Europe with 70% of the population younger than 35. The data on the unemployment rate and poverty are not that reliable. International Financial Institutions such as World Bank and IMF have different perceptions on the employment rate. It is believed that unemployment in Kosovo ranges from 25 to 40%, the highest in the Balkans.

There are 90,929 registered businesses in Kosovo, 89,447 (98.3%) of which are micro enterprises with 1-10 employees. Another 1,218 enterprises are registered as small enterprises with 10-49 employees. The above figures are good illustrations on how much the Kosovo economy relies on micro and small businesses which mostly are family businesses where the families are involved in the operations of these enterprises.

See Table 1 for a summary comparison of Kosovo to the other six countries.

Table 1. Country Data

| **Country** | **Population** (millions) | **Gross Domestic Product** US$ | **Per Capita GDP** US$ | **GEM** TEA Rate |
|---|---|---|---|---|
| **Kosovo** | **1. 8** | **5, 000, 000, 000** | **2, 300** | **NA** |
| Croatia | 4.5 | 69,980,000,000 | 16,100 | 3.6 |
| Egypt | 83.1 | 158,300,000,000 | 5,400 | NA |
| France | 64.1 | 2,978,000,000,000 | 32,700 | 3.2 |
| India | 1,166.1 | 1,237,000,000,000 | 2,800 | 17.9 |
| Kuwait | 2.7 | 159,700,000,000 | 57,400 | NA |
| USA | 307.2 | 14,330,000,000,000 | 47,000 | 10.5 |

*Sample*

The sample of Kosovo businesses were collected using personal interviews. The process resulted in 80 family businesses with a response rate of 85 percent. This is an excellent sample size and response rate for family business, as it has been reported that 62 percent of prior family business studies included no sample at all, or a sample with less than 100 family businesses, and 66 percent of these were convenience samples (Bird, Welsch, Astrachan & Pistrui, 2002). In three highly-rated small business and entrepreneurship-oriented journals (*Entrepreneurship Theory and Practice, Journal of Business Venturing, and Journal of Small Business Management*) around one-third of the articles had a response rate of less than 25 percent (Dennis, 2003).

*Measures and Statistical Analysis*

With correlations, the results are the same regardless of which variable is dependent or independent. Thus, for statistical testing of all nine hypotheses the test variable is the percentage of non-family-member managers, which is a ratio measure. The nine hypotheses variables in hypotheses testing are interval or ratio levels of measures. See Table 3 for a listing of variables with a brief explanation of operationalization and measure for each variable. To conserve space in this table, all hypotheses are denoted by summary phrases. In the actual survey instrument, the questions or statements used to collect the data were more substantial. Likert interval scales were used: “Describes our firm” 7-1 “Does Not Describe Our Firm.”

Based on level of measures, Hypotheses 1-9 were tested using Pearson Correlations. Higher level statistical regression is not appropriate because the purpose of the study was to determine relationships between variables, not to predict the percentage of managers based on the nine independent variables.

## Results

### Descriptive Statistics

See Table 2 for a summary of descriptive statistics discussed below.

Table 2. Descriptive Statistics

| **Variable** | **Total** (N = 80) |
|---|---|
| Generation ( n / %) | |
| 1st | 40 /50% |
| 2nd | 31 / 39% |
| 3rd | 9 / 11% |
| Years in business (mean / s.d.) | 11.81 / 8.35 |
| Industry ( n / %) | |
| Product | 18 / 23% |
| Service | 62 / 77% |
| Ownership ( n / %) | |
| Corporation, | 2 / 3% |
| Partnership, | 13 / 16% |
| Sole proprietorship | 65 / 81% |
| Number of employees (mean / s.d.) | 19.49 / 36.29 |

Distribution of Sample by Size (European Union Categories)

| **Size** | **Number of Employees** | **Sample (N =80)** |
|---|---|---|
| Large | ≥ 250 (250 +) | n = 0 / 0% |
| Medium | < 250 (50-249) | n = 8 / 10% |
| Small | < 50 (10-49) | n = 27 / 34% |
| Micro | < 10 (0-9) | n = 45 / 56% |

*Hypothesis Testing*

The results of the statistical testing are presented in Table 3. There was only one significant (positive) correlation ($p < .05$): between the percentage of non-family-member managers and the level of conflict: H3. As the percentage of non-family-member managers increases, so does the amount of conflict ($p = .015$).

Table 3. Correlations Hypotheses tests (N = 80)

| | *Mean/s.d.* (frequency) | *Coefficient* | *P-Value* |
|---|---|---|---|
| **Dependent Variable:** Percentage of Non-family managers | 18.00/27.10 | | |
| **Independent Variables:** | | | |
| H1. % of women involved in operation of business (percentage of women) | 27.2/25.63 | .080 | .480 |
| H2. Use of team-management decision style | 5.31/1.91 | -.055 | .631 |
| H3. Occurrence of conflict and disagreements | 2.16/1.64 | .272 | **.015** |
| H4. Formulation of specific succession plans | 3.69/2.43 | -.138 | .224 |
| H5. Use outside advisor/professional services | 3.59/2.35 | .123 | .279 |
| H6. Time spent in strategic planning | 4.66/1.99 | .090 | .428 |
| H7. Use sophisticated financial mgt methods | 5.36/1.97 | .076 | .502 |
| H8: Influence of original founder | 5.55/1.77 | .220 | .050 |
| H9. Consider going public | 3.03/2.42 | .112 | .324 |

(7-1) Likert scales "Describes our firm" 7 6 5 4 3 2 1 "Does not describe our firm."

## Discussion and Implications

Earlier analyses of these same variables in other countries produced a somewhat greater numbers of significant relationships than in this Kosovo study. For example, there were six significant relationships in France, five in the United States, and three in India. Thus this current study further indicates the need for additional research with regard to this issue of FMs versus NFMs.

Certainly the very small size of Kosovo – the nation, its economy, and its family businesses – has an impact upon these data results. Smaller than any of the six countries previously analyzed (in population, GNP, and in sample businesses size), generational influences can be expected to be more minimal. The value of this current study is thus not so much in its specific country findings but rather in its expansion of the total international family business database.

This train of research should be of both interest and value to practitioners, consultants and researchers. The findings of this study, combined with comparable and derivative future studies, should enable family business owner/managers to better understand the possible impacts of bringing non-family managers into a family business. Would there be likely changes in management activities, styles and characteristics, and would these changes be desirable and beneficial or dysfunctional for the firm? This is also a question that consultants to family businesses must consider as they analyze such firms and make recommendations regarding alternative strategies for growth.

For researchers in the field of family business, these findings build upon earlier and generally non-quantitative studies, provide some results that future research can focus on, replicate, and build upon, and may indicate some specific factors especially worthy of further investigation. Furthermore, this research raises many ideas for future research which, for example, might focus on factors not considered in this study, such gender issues, the varying levels of profit motivation among family firm owners, or the influence of different national cultures upon family business management practice. The potential scope for future research relating to family-member and non-family-member managers in family business is indeed extensive.

## Conclusions

Through its investigation of family-member managers versus non-family-member managers in family firms in Kosovo, this study further fills an identified gap in the family business literature. As discussed earlier, the limited prior writings on this specific family business issue reached few conclusions, with some writers postulating that NFM's strengthen a family firm (Coven, 1994a, 1994b; Donnelly, 1964; Dunn, 1995;Fiegener et. al., 1996; Horton, 1986; Leyton, 1970; Stewart, 2003; Whyte, 1996; Wong, 1988) and other researchers concluding the opposite (Carney, 2005; Chua, Chrisman and Sharma, 2003; Donnelly, 1964; Ensley & Pearson, 2005; Goody, 1996; Horton, 1986; Lane & Lubatkin, 1998; Marcus & Hall, 1992; Staff, 1981). As most of these earlier writers reached their deductions and findings through non-quantitative analyses, the authors' current series of empirical and quantitative analyses in various countries adds to the literature. As this research focus continues to be developed by scholars, this combination of qualitative and quantitative analyses should in combination allow us to better understand this issue of FM's versus NFM's (Guillén, 1994).

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# GENERATIONAL STAGES IN FAMILY FIRMS: EXPANDING THE DATABASE - KOSOVO

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## Abstract

Expanding the authors' international database of family businesses, this investigation compared first, second and third-generation family businesses in a sample from Kosovo. Both supporting and challenging the existing literature, the findings indicate that, as family businesses move from first to second to third generation, almost all managerial characteristics, activities and practices remain the same. Implications are presented for theory development, for further research, and for those who manage or advise family businesses.

## Introduction

Family firms constitute a highly important component of most countries' economies. In the United States, an estimated 80 percent of the total 15 million businesses are family businesses (Carsrud, 1994; Kets de Vries, 1993). Family businesses contribute more than 50 percent (McCann, Leon-Guerrero & Haley, 1997) to as high as 60 percent (Bellet et al., 1995) of the total Gross National Product, 50 percent of employment (Morris, Williams, Allen & Avila, 1997), and have higher annual sales than non-family businesses (Chaganti & Schneer, 1994). Estimates classify 35 percent of *Fortune 500* firms as family owned (Carsrud, 1994). Data from most other countries provide a similar picture. However, much of the family business literature, regardless of the country being investigated, is non-quantitative and relatively few articles have been published in broad-based business journals (Dyer & Sánchez, 1998; Litz, 1997).

This paper reports on an analysis of generational issues in a sample of family businesses in Kosovo, thus expanding earlier analyses by the authors in other countries. It investigates an especially limited segment of the literature, the study of similarities and differences among first, second and third-generation family businesses, as was suggested for further research by Morris et al. (1997). Furthermore, this study adds to the growing quantitative empirical body of family business literature and expands family business research beyond traditional geographical venues to global comparisons, as suggested by Hoy (2003)

## Literature Review

The field of Family Business has grown from modest beginnings to a substantial conceptual and theoretical body of knowledge at the start of the twenty-first century. Prior to 1975, a few theorists, such as Christensen (1953), Donnelley (1964) and Levinson (1971), investigated family firms, yet the field was largely neglected (Lansberg, Perrow & Rogolsky, 1988). These early studies were generally conceptual rather than empirical, with a focus on the more fundamental issues, such as what makes a business a "family business" or a "family firm" (the terms are used interchangeably), the dynamics of succession, intra-family conflict, and consulting to such firms (Handler, 1989; Sharma, Chrisman & Chua, 1997). In 1988, with the launching of the journal *Family Business Review*, the first and only scholarly publication devoted specifically to family business, the field reached a level of maturity to foster a significant progression and resulting body of research and findings.

A thorough analysis by Dyer and Sánchez' (1998) of all articles published in the first decade of *Family Business Review* provides a clear picture of directions in family business research. In descending order, the most frequent topics of articles published during this period were: Interpersonal family dynamics, Succession, Interpersonal business dynamics, Business performance and growth, Consulting to family firms, Gender and ethnicity issues, Legal and fiscal issues, and Estate issues. In terms of types of articles published, Dyer and Sánchez found that, over the decade analyzed, the proportion specifically describing the art of helping family businesses declined.

Even with this maturization of the field, a variety of definitions of "family business" continue to serve as the basis for the research and articles within this body of literature (Littunen & Hyrsky, 2000; Ward, 1986; Ward & Dolan, 1998). For the purposes of this study, a family business is one in which family members dominate the ownership and management of a firm, and perceive their business as a "family business." Furthermore, this research study recognizes all first-generation family firms as included in the definition. This definition is consistent with that of many prior studies (Chua, Chrisman & Sharma, 1999; Dreux & Brown, 1999; Gersick, Davis, Hampton & Lansberg, 1997; Litz, 1995).

The focus of this paper is an aspect of family business which has generally been relegated to a secondary or peripheral study in past studies. Specifically, as family firms move beyond the first generation of family member ownership and involvement in management, do changes occur? If family firms involve a *system* of 1) the family, 2) the individual family members, and 3) the business unit, how do generational changes in the system components impact each other? Are there significant differences between First-Generation Family Firms (1GFFs), Second-Generation Family Firms (2GFFs) and Third-Generation Family Firms (3GFFs)? And if there are significant differences, do they exist in family businesses in most countries? For this research, a 1GFF is defined as a family-owned and managed firm, with more than one family member involved, but only of the first and founding generation of the family. A 2GFF and a 3GFF are defined as firms in which the second or third generations of the family are also involved in the ownership and the management of the company. In a 2GFF or 3GFF, the original founder(s) and/or other members of earlier generations may be retired from the firm or deceased; thus not all (two or three) generations need be currently participating. Furthermore, in a 2GFF or a 3GFF, the locus of managerial and family primary leadership may be located at any generational level. This working definition is consistent with previous studies that dealt with generational issues in family firms (Beckhard & Dyer, 1983; Davis & Harveston, 1999; Dyer, 1988; Hershon, 1975; Schein, 1983), and with definitional issues (Handler, 1989; Kelly, Athanassiou & Crittenden, 2000). The existing literature suggests a variety of possible differences between first-generation and subsequent-generation family firms, but most studies' examinations of generational issues were only a small or tangential part of a larger focus on other or broader family firm issues, and these studies were most frequently limited to the United States or the United Kingdom.

This analysis of *generations* should be compared with another focus within the family business literature – a focus on developmental issues or the *stages* of the evolution of family business growth. For example, Gersick et al. (1997) present a developmental model of four typical stages in the growth of a family business, with significant analysis of the characteristics of the firm in each stage, and the implications regarding effective management in each stage. Others, such as

Peiser and Wooten (1983), focus on the *life cycle* changes in family businesses. While this developmental focus is important, these researchers admit to the complexity of this focus and the resulting models. In contrast, it is proposed that a *generational* focus is a less complex way to measure the development of a family business and therefore a valid alternative method, and it is furthermore proposed that theory and future models based on *generations* may be easier to use, especially for family business owner-managers and many of the consultants who assist such firms.

The following hypotheses derive from specific references in the family business literature to generations (1GFFs versus 2GFFs, and occasionally 3GFFs) and proposed similarities and differences between them. Because of the relatively limited prior research specifically focusing on generational issues in family business, it is important to recognize that these hypotheses are based largely on previous *findings* rather than on established *theories*.

## Hypotheses

As discussed earlier, this *generational* focus constitutes ground-floor research. Thus, at this stage of analysis a broad rather than narrow examination is appropriate. Therefore the hypotheses which follow derive from many different prior family business studies, wherever a potential relationship to generational issues was identified.

Dyer (1988) found that 80 percent of 1GFFs had a "paternalistic" management culture and style, but that in succeeding generations more than two-thirds of these firms adapted a "professional" style of management. "Paternalistic" management was characterized by hierarchical relationships, top management control of power and authority, close supervision, and distrust of outsiders. "Professional" management involved the inclusion, and sometimes the predominance, of non-family managers in the firm.

McConaughy and Phillips (1999), studying large publicly-owned founding-family-controlled companies, concluded that descendent-controlled firms were more professionally run than were founder-controlled firms. These writers postulate that first-generation family managers are entrepreneurs with the special technical or business backgrounds necessary for the creation of the business, but the founder's descendents face different challenges - to maintain and enhance the business - and these tasks may be better performed in a more professional manner, often by non-family members. Both Dyer (1988) and McConaughy and Phillips (1999) found an earlier basis in Schein (1983), who also suggested that subsequent generations in family firms tend to utilize more professional forms of management.

It can be argued that the *size* of a family business grows in subsequent generations, and that it is the *size* factor, rather than the *generation* factor that influences the level of "professionalism" in the management of a family firm (and similarly influences many of the other factors dealt with in the following hypotheses). Clearly, as this and other studies show, the size of a family business tends to expand with subsequent generations. It is not the intention of this study to control for size, but rather to focus on *generations* as a possible simple yet important measure by which to categorize family businesses. Thus, the above findings lead to:

H1: Subsequent-Generation Family Firms are more likely than First-Generation Family Firms to include non-family members within top management.

(For this and the following hypotheses, this phrasing means that 3GFFs are more likely than 2GFFs, and 2GFFs are more likely than 1GFFs.)

Nelton (1998) investigated gender issues in family firms and concluded that daughters and wives are rising to leadership positions in family firms more frequently than in the past, and that the occurrence of daughters taking over businesses in traditionally male-dominated industries is increasing rapidly. Focusing on societal trends rather than family firm generational issues, Cole (1997) found the number of women in family businesses increasing. More generally, U.S. Census Bureau data showed women-owned firms growing more rapidly than those owned by men (Office of Advocacy, 2001). While it might be argued that these societal trends would impact family businesses equally at all generational levels, Nelton's focus on daughters and succession more strongly relates to the focus of this study. Thus:

H2: Subsequent-Generation Family Firms are more likely than First-Generation Family Firms to have women family members working in the firm.

The distribution of decision-making authority in the firm is another aspect of family business behavior. As previously discussed, Dyer (1988) found decision-making to be more centralized in first-generation family firms than in subsequent-generation family firms. Aronoff (1998) developed this suggestion further and postulated that subsequent-generation family firms are more likely to engage in team management, with parents, children and siblings in the firm all having equality and participative involvement in important decision-making, even if one family member is still the nominal leader of the business. Aronoff furthermore reported that 42 percent of family businesses are considering co-presidents for the next generation. This leads to:

H3: Subsequent-Generation Family Firms are more likely than FirstGeneration Family Firms to use a "team-management" style of management.

Interpersonal dynamics, including conflict and disagreement among family members, has been a major focus of family firm research (Kellermanns & Eddleston, 2004). Conflict can exist in first-generation family firms, when siblings, spouses or other relatives participate in management and/or ownership, and conflict can also arise between members of different generations in subsequent-generation family firms. Beckhard and Dyer (1983) found that conflict among family members increases with the number of generations involved in the firm. Conversely, Davis and Harveston (1999, 2001) concluded that family member conflict increased only moderately as firms moved into the second-generation stage, but there was a more sizable increase from second to third-generation. This leads to:

H4: Subsequent-Generation Family Firms are more likely than First-Generation Family Firms to have conflict and disagreement between family members.

Another major focus of the literature on family firms has been succession. The primary issues here involve the difficulties founders have in "letting go" and passing on the reins of control and authority, the lack of preparation for leadership next-generation family members often receive,

and thus the need for, and importance of, succession planning (Davis, 1983; Handler, 1994; Upton & Heck, 1997). Dyer (1998) investigated "culture and continuity" in family firms, and the need for firm founders to understand the effects of a firm's culture and that culture can either constrain or facilitate successful family succession. Fiegener and Prince (1994) compared successor planning and development in family and non-family firms, and found that family firms favor more personal relationship-oriented forms of successor development, while non-family firms utilize more formal and task-oriented methods. Building upon these and other studies of succession in family firms, Stavrou (1998) developed a conceptual model to explain how next-generation family members are chosen for successor management positions. This model involves four factors which define the context for succession: *family*, *business*, *personal* and *market*.

Some of the earlier family business studies have dealt with various aspects of succession, but none have specifically investigated succession planning and practices in first-generation versus subsequent-generation family firms. Still, given that the importance of succession has been well established and publicized, and that family firms often experience the trials of succession as they move from one generation to the next, it would be expected that subsequent-generation family firms are more likely to recognize the importance of succession than are first-generation family firms and respond accordingly. Thus:

H5: Subsequent-Generation Family Firms are more likely than First-Generation Family Firms to have formulated specific succession plans.

A number of earlier researchers of family firms have postulated that, as these firms age and/or move into subsequent-generation family management and ownership, they also progress from one style of management to another. Informal, subjective and paternalistic styles of leadership become more formal, objective and "professional" (Aronoff, 1998; Cole & Wolken, 1995; Coleman & Carsky, 1999; Dyer, 1988; Filbeck & Lee, 2000; McConaughy & Phillips, 1999; Miller, McLeod & Oh, 2001; Schein, 1983).

"Professional" management may involve the following: (a) the use of outside consultants, advisors and professional services, (b) more time engaged in *strategic* management activities, and (c) the use of more sophisticated financial management tools. These conclusions lead to three hypotheses:

H6: Subsequent-Generation Family Firms are more likely than First-Generation Family Firms to use outside consultants, advisors and professional services.

H7: Subsequent-Generation Family Firms spend more time engaging in strategic management activities than First-Generation Family Firms.

H8: Subsequent-Generation Family Firms are more likely than First-Generation Family Firms to use sophisticated methods of financial management.

Still another issue of interest in the investigation of family business is "generational shadow" (Davis & Harveston, 1999). In a multi-generation family firm a generational shadow, shed by the founder, may be cast over the organization and the critical processes within it. In such a situation, "succession" is considered incomplete, may constrain successors, and may have dysfunctional effects on the performance of the firm. Yet this "shadow" may also have positive impact, by providing a clear set of values, direction and standards for subsequent firm managers. Kelly et al. (2000) similarly proposed that a family firm founder's "legacy centrality" will influence the strategic behavior of succeeding generations' family member managers, with both positive and negative impact. Davis and Harveston (1999) also investigated generational shadow, but reached mixed conclusions regarding its impacts. If "generational shadow" and "legacy centrality" are valid components of the family business system, then management in both first-generation family firms (with the founder in control) and in subsequent-generation family firms (with the founder having strong presence even if not actually there) should be influenced by the objectives and methods of the founder:

H9: Top management styles and decisions in Subsequent-Generation Family Firms are neither more nor less likely than in First-Generation Family Firms to be influenced by the original business objectives and methods of the founder.

Although most family firms are privately owned, some are not. As family firms grow and/or as they move into subsequent generational involvement, opportunities and needs for "going public" may arise. The family may not be able, or may not choose, to provide sufficient management or financial resources for growth, and outsider ownership can resolve this situation. And even publicly owned companies can continue as "family businesses," if management or financial control is maintained by the family. In the United States, McConaughy (1994) found that 20 percent of the *Business Week 1000* firms are family-controlled, while Weber and Lavelle (2003) report that one-third of *S & P 500* companies have founding families involved in management. Thus:

H10: Subsequent-Generation Family Firms are more likely than First-Generation Family Firms to have considered "going public."

Decisions with regard to capital structure decision are important for family businesses (Romano, Tanewski & Smyrnios, 2001). Following from the preceding discussion, subsequent-generation family firms may use equity financing rather than debt financing, as they grow through the sale of company stock. Cole and Wolken (1995) and Coleman and Carsky (1999) found that older and larger family firms use more equity financing and less debt financing than younger and smaller family firms.

Yet other researchers have found that family businesses, and especially first-generation ones, are reluctant to use debt financing (Bork, Jaffe, Jane, Dashew & Heisler, 1996; Gersick et al., 1997). Thus, with the literature pointing in both directions:

H11: Subsequent-Generation Family Firms are neither more nor less likely than First-Generation Family Firms to use equity financing rather than debt financing.

## METHODOLOGY

*Country Selection*

*The opportunity to collect data in Kosovo provided continued expansion of the authors' data base of family businesses. Earlier analyses of family businesses have been conducted in Croatia, Egypt, France, India, Kuwait, and the United States.

The Republic of Kosovo, with a population of about 2 million, is located in the center of the Balkan Peninsula. Kosovo is a new country which is in the early stages of creating a market driven economy with minimal intervention from the government. Kosovo imports mostly come from Macedonia and Serbia, as well as from other European countries.

Kosovo's GDP in 2008 was 3.8 billion Euros, just above 1,800 Euros per capita, the lowest in the Balkans. Kosovo's economy relies heavily in remittances from abroad, which represent up to 15% of the GDP, as well as foreign direct investments. Kosovo is one of the poorest countries in Europe with 70% of the population younger than 35. The data on the unemployment rate and poverty are not that reliable. International Financial Institutions such as World Bank and IMF have different perceptions on the employment rate. It is believed that unemployment in Kosovo ranges from 25 to 40%, the highest in the Balkans.

There are 90,929 registered businesses in Kosovo, 89,447 (98.3%) of which are micro enterprises with 1-10 employees. Another 1,218 enterprises are registered as small enterprises with 10-49 employees. The above figures are good illustrations on how much the Kosovo economy relies on micro and small businesses which mostly are family businesses where the families are involved in the operations of these enterprises.

See Table 1 for a summary comparison of Kosovo to the other six countries.

Table 1. Country Data

| **Country** | **Population** (millions) | **Gross Domestic Product** US$ | **Per Capita GDP** US$ | **GEM** TEA Rate |
|---|---|---|---|---|
| **Kosovo** | **1.8** | **5, 000, 000, 000** | **2, 300** | **NA** |
| Croatia | 4.5 | 69,980,000,000 | 16,100 | 3.6 |
| Egypt | 83.1 | 158,300,000,000 | 5,400 | NA |
| France | 64.1 | 2,978,000,000,000 | 32,700 | 3.2 |
| India | 1,166.1 | 1,237,000,000,000 | 2,800 | 17.9 |
| Kuwait | 2.7 | 159,700,000,000 | 57,400 | NA |
| USA | 307.2 | 14,330,000,000,000 | 47,000 | 10.5 |

*Samples*

The sample of Kosovo businesses were collected using personal interviews. The process resulted in 80 family businesses with a response rate of 85 percent. This is an excellent sample size and response rate for family business, as it has been reported that 62 percent of prior family business studies included no sample at all, or a sample with less than 100 family businesses, and 66 percent of these were convenience samples (Bird, Welsch, Astrachan & Pistrui, 2002). In three highly-rated small business and entrepreneurship-oriented journals (*Entrepreneurship Theory and Practice, Journal of Business Venturing, and Journal of Small Business Management*) around one-third of the articles had a response rate of less than 25 percent (Dennis, 2003).

*Measures*

*Dependent variables.* The dependent variables to test Hypotheses 1-11 were as follows. (H1) Does the firm have non-family managers?—the percentage of family to non-family managers. (H2) The percentage of male and female family members involved in the operation of the firm. Hypotheses 3-10 were Likert interval scales of:

"Describes our firm" 7 6 5 4 3 2 1 "Does not describe our firm."

(H3) full family involvement in decisions, (H4) level of family conflict, (H5) formulation of succession plans, (H6) use of outside advisors, (H7) long-range thinking and decision-making, (H8) use of sophisticated financial management tools, (H9) influence of founder, and (H10) considering going public. (H11) The use of debt or equity financing was a nominal measure of one or the other. Descriptive statistical data included number of years the firm was in business, the number of employees, industry (product or service), and form of ownership.

*Independent variable*: The independent variable for the first 11 hypotheses was the number of generations involved in the operations of the family business. The nominal measure was one, two or three or more generations.

*Analysis of Variance*

Hypotheses 1-10 compared the dependent variable among the three generations using one-way ANOVA. Hypothesis 11, having nominal measured variables, compared debt to equity by generations using chi-square.

## Results

See Table 2 for a summary of descriptive statistics. Also, see Table 3 for a comparison of the means for the dependent variables and the results of hypotheses testing. The numerical statistical test result data are presented in this table.

Table 2. Descriptive Statistics

| **Variable** | **Total** (N = 80) |
|---|---|
| Generation ( n / %) | |
| 1st | 40 /50% |
| 2nd | 31 / 39% |
| 3rd | 9 / 11% |
| Years in business (mean / s.d.) | 11.81 / 8.35 |
| Industry ( n / %) | |
| Product | 18 / 23% |
| Service | 62 / 77% |
| Ownership ( n / %) | |
| Corporation, | 2 / 3% |
| Partnership, | 13 / 16% |
| Sole proprietorship | 65 / 81% |
| Number of employees (mean / s.d.) | 19.49 / 36.29 |

Distribution of Sample by Size (European Union Categories)

| **Size** | **Number of Employees** | **Sample (N =80)** |
|---|---|---|
| Large | ≥ 250 (250 +) | n = 0 / 0% |
| Medium | < 250 (50-249) | n = 8 / 10% |
| Small | < 50 (10-49) | n = 27 / 34% |
| Micro | < 10 (0-9) | n = 45 / 56% |

Table 3. One Way ANOVA Hypotheses Tests (N = 80)

| **Variables** | *Mean/s.d.* (frequency) | *F* | *P-Value* |
|---|---|---|---|
| Generation—IV used to test 11 Hypotheses DVs ($1^{st}$, $2^{nd}$, $3^{rd}$) | (40/31/9) | | |
| H1. Percentage of Non-family managers | 18.00/27.10 | .341 | .712 |
| H2. Percentage of women involved business | 27.2/25.63 | 1.234 | .297 |
| H3. Use of team-management decision style | 5.31/1.91 | .456 | .635 |
| H4. Occurrence of conflict and disagreements | 2.16/1.64 | .481 | .620 |
| H5. Formulation of specific succession plans | 3.69/2.43 | .409 | .666 |
| H6. Use outside advisor/professional services | 3.59/2.35 | 1.002 | .372 |
| H7. Time spent in strategic planning | 4.66/1.99 | .954 | .390 |
| H8. Use sophisticated financial mgt methods | 5.36/1.97 | 3.170 | **.048** |
| H98: Influence of original founder | 5.55/1.77 | .196 | .823 |
| H10. Consider going public | 3.03/2.42 | 10276 | .285 |
| H11. Debt or equity financing (Chi-Square test) | (31 / 49) | .474 | .789 |

(7-1) "Describes our firm" 7 6 5 4 3 2 1 "Does not describe our firm."

There was only one of the 11 ANOVA tests that had a significant difference. The generation use of sophisticated financial methods was $1^{st}$ mean 4.85, $2^{nd}$ mean 6.0, and $3^{rd}$ mean 5.44. The post hoc multiple comparisons test of differences between generations found that there is a significant difference in the use of financing between the first and the second generations, but the difference between the second and third generations, and the first and third generations, is not significant. Thus, we can conclude that as the family business moves from the first to second generation, it makes greater use of sophisticated financial methods but not as it moves from second to third generation.

## Discussion

Clearly, much of the earlier literature findings regarding possible generational differences among family firms are not supported by this study. In most respects, 1GFFs, 2GFFs and 3GFFs in Kosovo share the same characteristics and behavior patterns. These findings are generally consistent with the authors' more recent findings in other countries. Thus, these current results do not support the earlier findings and conclusions of Aronoff (1998), Beckhard and Dyer (1983), Cole and Wolken (1995), Coleman and Carsky (1999), Davis and Harveston (1999, 2001), Dyer (1988), Filbeck and Lee (2000), McConaughy and Phillips (1999), Miller, et al. (2001), and Schein (1983), all of whom found and/or postulated generational differences among family businesses (as discussed in detail in the *Generational Hypotheses* section).

Certainly the very small size of Kosovo – the nation, its economy, and its family businesses – has an impact upon these data results. Smaller than any of the six countries previously analyzed (in population, GNP, and in sample businesses size), generational influences can be expected to be more minimal. As discussed below, the value of this current study is primarily in its expansion of the total international family business database.

## Implications

There are several important contributions of this study and its findings. Beyond the authors' studies, prior family business research has rarely focused specifically on comparisons of first, second, and third-generation firms. The few other investigations of this issue have generally been conceptual or otherwise qualitative, or a tangential empirical analysis within a larger family business study (Beckhard & Dyer, 1983; Davis & Harveston, 1999; Dyer, 1988; Hershon, 1975; Schein, 1983). Thus, this study extends ground-floor empirical investigation of this specific issue, and adds to the limited existing and primarily qualitative body of literature.

A better understanding of these generational similarities and differences might direct and enable entrepreneurship, small business, and family firm researchers to better focus their future investigations and theory development into these three generational categories as separate entities, might strengthen the effectiveness of advisors, consultants, and others who assist family firms by allowing them to differentiate, as needed, between their first, second and third-generation family business clients, and also might assist family business owner-managers in their understanding and self-analyses of their businesses.

Another important contribution of this study is that it extends the authors' prior investigations of this subject into a new country – Kosovo. As more countries are added to the authors' family business data base, the value of their research grows.

Lastly, the findings of this study with regard to generational analyses provide data that are different from the conclusions reached by most of the limited previous conceptual and empirical research. This raises questions about these earlier conclusions and indicates a need for further empirical research.

## Conclusion

In summary, this investigation compared first, second and third-generation family businesses in a sample from Kosovo. Both supporting the authors' various prior country studies and yet challenging the earlier more conceptual literature, the findings of this study indicate that, as family businesses move from first to second to third generation, most managerial characteristics, activities and practices remain the same. Implications have been presented for theory development, for further research, and for those who manage or advise family businesses.

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# UNDERSTANDING STRATEGIC RELATIONSHIPS IN SMALL AND MEDIUM SIZED ENTERPRISES: THE IMPORTANCE OF INFORMATION QUALITY AND CONTINUOUS QUALITY IMPROVEMENT

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## Abstract

This study examines the performance between operational variables for small and medium sized business (SMEs) within the context of interorganizational relationships. Specifically, it investigates the role of information quality and continuous quality improvement and the varying importance that SMEs place on each of these constructs. The sample consists of 134 vendors of a large university in the southwestern region of the United States. The results indicate that there is a positive relationship between information quality and continuous quality improvement with performance in SMEs. Implications for both research and practice are discussed, as well as ideas for future research.

## Introduction

Much of the past research on strategic alliances has focused on multinational companies with diverse and complex operations (Das & He, 2006; Kelly, 2007). However, in the current business environment these partnerships have become important for all types of businesses, and more research is warranted in the small business arena (Kelly, 2007). Small and medium sized businesses (SMEs) are often more entrepreneurial in nature and can vary greatly from large companies. According to Das and He (2006), these differences can be both intrinsic and extrinsic in nature, and must be accounted for when attempting to identify prospective partners for strategic relationships.

In order to remain competitive SMEs often work with other organizations through a variety of collaborative efforts to achieve greater performance and remain competitive (Astley & Van de Ven 1983; Nooteboom, 2000). These coordinated efforts can come in the form of networks, joint ventures, strategic alliances, or other forms of interorganizational relationships that allow for the sharing of information, resources, and risk (Das & He, 2006; Li & Qian, 2007). However, the nature of the relationships among SMEs can be unique and often more varied than the traditional alliances of large corporations, particularly in terms of innovation, bargaining power, resource allocation, learning ability, and organizational capability.

Fortunately, many SMEs are often well suited to participate in strategic alliances. Some of these advantages include centralized decision making, flexibility, limited organizational structure, and a focus on sustainability and growth (Gélinas & Bigras, 2004; Das & He, 2006). In addition to suitability, SMEs often need the benefits that come from outside networks in order to compensate for resource limitations and inadequate internal infrastructure.

These constraints have been well documented as primary obstacles to new firm development and growth. While emerging SMEs are particularly susceptible to these restrictions, more established firms also struggle to find appropriate business networks. Interestingly, Dodge and Robbins (1992) and Harris, Grubb and Herbert (2005) found that external problems are more prevalent in the development stage of a small business as it attempts to develop legitimacy and

find its niche in the marketplace. This seems to indicate that strategic alliances can be especially beneficial for nascent entrepreneurs. Research has shown that the development of long-term relationships with other organizations can increase the viability and survival for small businesses (Aldrich & Auster, 1986), and the absence of such relationships may contribute to higher failure rates (Baum, Calabrese & Silverman, 2000).

The purpose of this study is to investigate interorganizational relationships in SMEs, and the impact of operational variables on internal performance. Specifically, our goal is to examine the relationship among information quality and continuous quality improvement with performance in SMEs.

## Literature Review

*Small Business*

Past research (Saunders, 1997; Fuller & Lewis, 2002; Das & He, 2006; Kelly, 2007; Li & Qian, 2007) has encouraged small business owners to develop mutually beneficial relationships with external constituencies in order to effectively compete with larger firms. SMEs are often faced with resource limitations that cause them to be vulnerable to various environmental changes. The adoption of relationship strategies to develop both formal and informal strategic alliances can be critical in order to sustain external relations and effectively adapt to the constant change that exists in the business world.

One such advantage of strategic relationships is the ability for SMEs to further develop a core competency. As suggested by Li and Qian (2007), effective alliances can help SMEs become more innovative by focusing efforts on specific ideas and concepts. These alliances can also help reduce resource constraints and provide opportunities for growth and sustained value creation. An advantage of many SMEs, particularly emerging businesses, is that they are able to adapt quicker than their larger counterparts and often have a culture based on openness and trust.

Another advantage is the access to additional resources and learning opportunities that can translate into cost reductions and greater future performance (Beekman & Robinson 2004). As stated by Sawhney and Zabin (2002), business-to-business relationships can create value networks that makeup a “business ecosystem” (p. 315). This ecosystem can provide benefits that enhance the competitive advantage for all parties involved. Basu (2001) argues that it is imperative for business to share knowledge and best practices if they are to succeed in a collaborative economy. Empirical research (O’Farrell & Wood, 1997; Kelly, 2007) has shown the value of professional networks in developing and refining capabilities and capacity. Specially, SMEs can gain cost and service advantages and greater flexibility from strategic relationships, and these improvements are likely to strengthen their overall competitive advantage (Miller, 1988; Kelly, 2007).

The establishment of strategic alliances alone is not enough. In order to reap the benefits of these relationships all parties involved must gain value from the association. Research has shown that owners of SMEs often look for partnerships with businesses that offer a complimentary contribution and a shared agreement of fundamental values and trust (Hoffman & Schlosser, 2001). Similarly, Saunders (1997) and Fuller and Lewis (2002) argue that SMEs should seek out organizations in which they can develop mutually beneficial relationships. According to Das and

He (2006), the best strategic relationships for entrepreneurial businesses are based on compatible motivations, access to complimentary business functions, and involvement and commitment from all levels of the organization. They also highlight the importance of developing purposeful relationships and acting in a timely manner to secure commitments.

SMEs need to constantly identify ways to lower costs, increase productivity, and strengthen their competitive advantage (Mentzer, DeWitt, Keebler, Min, Nix & Smith 2001; Das & He, 2006). Likewise, researchers continue to examine all types of variables in relationship to SME performance, including both relational and operational variables. In terms of operational variables, information quality (Huber & Daft, 1987) and continuous quality improvement (Deming 1975; Prybutok & Ramasesh, 2005) are two of the more important aspects of interorganizational relationships that can affect firm performance. Additional research on these variables is needed in order to better understand their impact in the small business context.

*Information Quality*

Information quality has been defined as the degree to which the information received from another is accurate, timely, complete, adequate, and credible (Daft & Lengal, 1986; Huber & Daft, 1987; Monczka, Peterson, Handfield & Ragatz, 1988). Information exchanged between parties must be systematically available for the effective completion of required tasks (Guetzkow 1965) and interorganizational success is often somewhat dependent upon effective and efficient communication (Huber & Daft, 1987). This exchange of information can predict the success of the partnership of the actors (Devlin & Bleakley, 1988).

In supply chains, companies find reduction in costs and better utilization of resources by utilizing continually advanced systems in information flow (Gopal & Cypress, 1993, Martin 1995). Through more advanced exchanges of information, the transaction between members can be much quicker (Murphy 1998). These benefits are becoming more available to companies through technological advancements which facilitate these exchanges, and thus enables greater performance (Stefansson, 2002). This better and more complete information allows firms to plan key variables, such as capacity of the supplier, which creates a more efficient chain (Chapman & Carter, 1990; Raturi, Meredith, McCutcheon & Camm, 1990). Ellram and Hendrick (1995) found in their study on supply chain relationships, that partnering organizations continually share information needed for mutual understanding, operational information necessary for smooth operations, and information regarding high corporate level issues important for good coordination.

When applying path-goal theory (House 1971) to the interorganizational relationship and the exchange of information, the leader, or the buyer in this sense, must provide the supplier with the information of what exactly is to be expected. When looking at SMEs, the level of quality information at the beginning of the exchange as well as throughout the transaction must be thorough. Thus, it is expected that when SMEs receive more meaningful and timely information there will be a greater opportunity to perform well. Therefore, the following hypothesis is given.

Hypothesis 1: A positive relationship exists between perceived information quality and performance for small and medium-sized businesses.

*Continuous Quality Improvement*

Continuous quality improvement (CQI) is the process within organizations that seeks higher quality within an organization that will lead to better products and services with lower defects and with lower costs (Deming, 1975; Prybutok & Ramasesh, 2005). There are three primary elements of CQI within this definition. First is the quality of data and information gathered internally within the organization. Second is the use of the internal and external quality data by the organization. Third is the quality documentation by the organization internally. Pence (1993) emphasizes the need for suppliers to adhere to and follow the paths towards quality improvement to maintain strong relationships with partnering and collaborating organizations.

Prior research has indicated that quality practices within an organization are statistically significantly related to success within that organization. Just two of these quality practices that lead to success are service quality (Magal, 1991; Rands, 1992; Ferguson & Zawacki, 1993), and system quality (Davis, 1989). The benefits of CQI are lower costs, information accuracy, and lowers defects. Within the interorganizational setting, CQI is seen as a capability because it suggests that the processes and systems exist to more effectively and efficiently carry out the organizations tasks with a minimum of waste. It is expected, however, that SMEs are more concerned with continuing the CQI process. SMEs, with spread out resources and commitments, rely on CQI to improve their ability to meet each of their buyers needs. Therefore, in this context, it is expected that these organizations will see CQI as positively related to firm performance. Thus, the following hypothesis is given.

Hypothesis 2: A positive relationship exists between continuous quality improvement and performance for small and medium-sized businesses.

## Methodology

*Sample*

An electronic survey was administered via email to the approved vendors for a university in the southwestern United States. The respondent for each vendor was the primary contact for the university and vendor. Of the 498 accessed surveys, 156 surveys were completed indicating a 31percent response rate of those accessing the survey. Of the 156 completed surveys, there were 134 usable surveys that were considered an SME with fewer than 500 employees after removing those cases with low response rate. The average size firm is 34 employees.

*Measures*

Participants were asked to specify the size of the organization by giving the number of employees (Kimberly & Evanisko, 1981). As has been mentioned earlier, the size of the organization can impact the relationship between the supplier and the buyer (Redondo & Fierro, 2007). In addition, respondents were asked for the number of years the organization has been a vendor to the university to assess the degree of institutionalization, which can potentially affect the vendor's ability to respond to customer demands (Dimaggio & Powell, 1983). The average length of time the organization has been working with the university is 6.39 years. They were also asked to indicate the length of time that he or she has worked with the organization which can help to indicate the person's tendency to observe, accept, and adopt the values and norms of the organization (Chao, O'Leary-Kelly, Wolf, Klein & Gardner, 1994). The average length of time the respondent has been working with the company is 9.49 years.

Information quality was examined using five dimensions of information-- accuracy, timeliness, adequacy, completeness and credibility (Daft & Lengal, 1986; Huber & Daft, 1987; Moczka et al., 1998). Using Mohr and Spekman's (1994) five questions on information quality (previous α = .910) respondents indicated their level of trust on a seven point Likert type scale ranging from (1) not timely (accurate, adequate, etc.) to (7) very timely (accurate, adequate, etc.).

Continuous quality improvement (Deming, 1975; Prybutok & Ramasesh, 2005) consists of three factors: quality data and information gathering, quality internal and external data usage, and quality documentation. These factors were assessed using an adaptation of Prybutok and Spink's (1999) seven items for continuous quality improvement (previous α = .852). These seven items were tested using a seven point Likert type scale with responses ranging from strongly disagree (1) to strongly agree (7).

The items assessing performance were designed specifically for this study. They were developed through an examination of the literature and based on the expectations of the business relationship. These seven items assessed performance in areas ranging from on time delivery and full compliance to using approved products and procedures. These items were measured using a seven point Likert scale ranging from strongly disagree (1) to strongly agree (7).

*Data and Scale Analysis*

The data were screened and prepared using Kline's (1997) recommended procedures. After a full analysis, cases with missing data points, as well as outliers identified with the frequency distribution of standard scores, were removed. Univariate normality was assessed by examining each item for skewness and kurtosis. The test showed a normal distribution. Cronbach's alpha was used to establish the reliability of the scales (Nunnally & Bernstein, 1994; Henson, 2001). The coefficient alpha's for each scale was well above Nunnally and Bernstein's (1994) suggested reliability coefficient of .70. These reliability estimates are found in Table 1.

Table 1. Factor Pattern/Structure Coefficient for All Constructs

| Variable Item # | Information Quality | | CQI | | Performance | |
|---|---|---|---|---|---|---|
| | Factor | $h^2$ | Factor | $h^2$ | Factor | $h^2$ |
| 1 | .847 | .717 | .846 | .716 | .792 | .627 |
| 2 | .964 | .929 | .867 | .752 | .794 | .631 |
| 3 | .930 | .865 | .864 | .747 | .863 | .745 |
| 4 | .958 | .918 | .847 | .718 | .828 | .686 |
| 5 | .906 | .821 | .801 | .641 | .866 | .749 |
| 6 | *n/a* | *n/a* | .916 | .839 | .769 | .591 |
| 7 | *n/a* | *n/a* | .900 | .810 | .864 | .747 |
| Total Variance Explained | 84.911 | | 74.458 | | 68.364 | |
| Initial Eigenvalue | 4.250 | | 5.223 | | 4.777 | |
| Second Eigenvalue | .347 | | .684 | | .579 | |
| Alpha | α = .955 | | α = .943 | | α = .922 | |

The item scores were assessed to evaluate the consistencies of the measurement items with construct validity. Utilizing a confirmatory factor analysis (Ahire & Deveraj, 2001), LISREL was used to examined the latent variable with its corresponding items. The latent constructs were analyzed using principle components factor analysis to extract the analysis pattern. Using the K1 rule (Kaiser 1960), each item extracted only one factor. Therefore, there is only one latent construct per list of variables (Hattie, 1985). The factor pattern/structure coefficients as well as the communalities, eigenvalues, and Cronbach's alphas are presented in Table 1. A LISREL model assessed the fit of the individual items with the latent construct. Examining the fit indices allows for a test of discriminant validity. The analysis shows that the scale reliabilities are sufficiently larger than the correlation averages with other constructs, the interscale correlations are not perfectly correlated, and the variance extracted are greater than the squared intercorrelations of the latent variable. This does indicate a good fit. The results of the analysis are found in Table 2. In addition, the overall means, standard deviations, Cronbach's alphas, and correlations of the latent variables are found in Table 3.

Table 2. Construct Fit Indices

| Construct | $\chi^2$ | d.f. | CFI | GFI |
|---|---|---|---|---|
| Information Quality | 3.37 | 5 | 1.0 | .99 |
| CQI | 174.64 | 14 | .89 | .73 |
| Performance | 37.69 | 14 | .98 | .93 |

Table 3. Means, Standard Deviations, Cronbach's Alphas, and Correlations

| Construct | Means | S.D. | 1 | 2 | 3 |
|---|---|---|---|---|---|
| Information Quality | 5.816 | 1.075 | (.955) | | |
| CQI | 6.105 | .914 | .380* | (.943) | |
| Performance | 6.228 | .793 | .606* | .444* | (.922) |

Note: *Correlations are significant at the 0.01 level (2-tailed). Reliability coefficients are presented on the diagonal.

## Results

The purpose of this study is to examine the relationship of both information quality and continuous quality improvement with performance in SMEs. Hypothesis one stated that there is a positive relationship between information quality and performance in SMEs. In addition, hypothesis two states that there is a positive relationship between continuous quality improvement and performance. The hypotheses were tested by first entering the control variables of organizational size, the number of years with the company and the number of years working for the buyer and the number of years working as a manager for this company. Following this, both information quality and continuous quality improvement were entered into the regression model.

The first model with only the control variables resulted in an ANOVA with an F statistic of .182 that was not statistically significant ($p > .05$). The second model, which includes both the control variables as well as information quality and continuous quality improvement, was statistically significant with an ANOVA with an F statistic of 18.579 ($p < .05$). These two predictor variables improved the fit of the model with an $R^2$ of .421, an adjusted $R^2$ of .398, and

a $\Delta R^2 = .416$ that was statistically significant ($p < .05$). In addition, the relationship of the predictor variables with performance was examined using standardized and unstandardized coefficients, statistical significance, and confidence intervals. For a summary of these results, see Table 4. The results of the regression analysis indicate that both information quality and continuous quality improvement are statistically significantly related to performance in SMEs ($p < .01$), thus supporting Hypotheses one and two.

Table 4. Results of Regression Analysis for Prediction of Performance in SMEs

| Variable | *B* | *SE B* | β | 95% CI Lower | 95% CI Upper | VIF |
|---|---|---|---|---|---|---|
| Step 1: | | | | | | |
| # of Employees | .000 | .001 | .000 | -.003 | .003 | 1.044 |
| Comp Years | .006 | .010 | .051 | -.014 | .025 | 1.062 |
| Manager Years | .003 | .009 | .031 | -.014 | .020 | 1.087 |
| Step 2: | | | | | | |
| # of Employees | .000 | .001 | -.004 | -.002 | .002 | 1.046 |
| Company Years | -.002 | .008 | -.021 | -.018 | .013 | 1.084 |
| Manager Years | .004 | .007 | .046 | -.009 | .018 | 1.098 |
| Information Quality | .381 | .054 | .517* | .274 | .489 | 1.196 |
| CQI | .212 | .064 | .244* | .086 | .338 | 1.186 |

Note. $R^2$ for first model = .004 $R^2$ for second model = .421 $\Delta R^2 = .416$
*$p < .01$ N = 134 Two-tailed tests.

## Discussion

The results of this study support both of the hypotheses indicating that in SMEs information quality and continuous quality improvement are positively related to performance. These findings not only add to the literature base, but also provide practical implications for SMEs in regards to building stronger relationships with other organizations. SMEs generally have access to limited resources and technologies needed to process information and improve operations, making it important to understand how to best develop strategic alliances that positively affect firm performance.

SMEs should focus on sharing information that allows for both relationship development and continuous quality improvement. This requires an exchange based on quantity and quality of the information, in a manner that creates trust and commitment within the partnering organizations (Hoffman & Schlosser, 2001). As suggested in prior research (Das & He, 2006; Li & Qian, 2007), strong alliances are built on sharing information and resources, thereby reducing risk for all parties involved. By sharing relevant information in a timely manner SMEs gain more strategic flexibility that enables them to refine their capabilities and improve performance (O'Farrell & Wood, 1997; Kelly, 2007).

While continuous improvement can help SMEs better serve existing customers, it can also be used to develop new internal processes that make them less dependent on a limited customer base and more focused on future growth. As suggested by Beekman and Robinson (2004), effectiveness is important in developing a long-term customer relationship, but ineffectiveness may be more important in determining the duration of the relationship. Although it is critically important for a SME to effectively serve its current customers, it is also important to continually

identify new sources for revenue and expanded capacity in order to maximize performance. This can hopefully allow for the creation of a competitive advantage that is sustainable, which in turn increases long-term viability (Aldrich & Auster, 1986). As suggested by Baum, Calabrese and Silverman (2000), without such relationships SMEs are often faced with lower growth potential and higher failure rates.

As indicated in past research (Morrissey & Pittaway, 2006; Devins, Gold, Johnson & Holden, 2005), developing SMEs are likely to become emotionally involved with customers and learn through social interaction rather than formalized business practices. Conversely, larger SMEs with greater resources and technologies tend to become more reliant on the flow of detailed information to make business decisions and manage customer relations. The adoption of better integrated systems allows these larger SMEs to collect more information and process it quickly to handle complex transactions (Gélinas & Bigras, 2004). As SMEs grow and mature it is important that they create formalized arrangements and strategic alliances and rely less on social factors and more on internal processes (Morrissey & Pittaway, 2006). While SMEs are generally well suited for strategic relationships due to their centralized decision making and flexible organizational structure, these businesses can vary greatly in terms of size and scope, thereby making it critically important to identify appropriate partners with a similar culture and complimentary resources. Once the alliance begins information quality and continuous quality improvements become important factors in the maturation of the relationship.

While the importance of operational variables often becomes more important as SMEs grow and mature, various social factors can also greatly impact interorganizational relationship, regardless of firm size. In particular, trust, personal values, and reciprocity can play a vital role in partner identification and relationship building (Lawson, 1992; Hu & Korneliussen, 1997; Hoffmann & Schlosser, 2001). While we found that information quality is important for firm performance, additional exploration is needed to determine what communication processes work best within SMEs to allow for the flow of accurate and detailed information. These processes must not only allow for the flow of reliable data, but in a manner that effectively serves all partners and allows for continuous improvement. Interfirm cooperation is required, particularly among SMEs, if an alliance is successful and leads to increased productivity and growth (Das & He, 2006).

## Future Research

Research has shown that there are many influences that impact business relationships and organizational performance. The intent of this study was to examine some of the predictors of performance within SMEs. We found that SMEs are dependent on information quality and well designed internal processes for quality and performance. These findings are important for both future research and practice. However, researchers must continue to examine how other operational variables impact strategic decisions and firm performance. In addition, owners and managers of SMEs must be aware of what factors affect interorganizational relationships in order to develop best practices for exchanging information, maximizing resources, and encouraging continuous quality improvement. Additional research is particularly needed within the small business arena to better understand business-to-business relationships and professional networks and what role they play in the future success of SMEs in today's ultra competitive marketplace.

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# INVESTIGATING THE ENTREPRENEURIAL ATTITUDES OF AFRICAN AMERICANS: A STUDY OF YOUNG ADULTS

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## Abstract

An examination of the entrepreneurial attitudes of African American business students from multiple universities was conducted. Entrepreneurial attitudes were measured with the Entrepreneurial Attitudes Orientation (EAO) scale. Findings indicate that African American students have very high entrepreneurial attitudes compared with the validation sample of the EAO, and that these attitudes are even higher among those who have had prior entrepreneurial exposure via a family-owned or self-owned business. These findings are believed to be consistent with current rates of minority-started businesses and known intergenerational linkages in business ownership.

## Introduction

As noted in multiple reports from the Global Entrepreneurship Monitor (GEM), entrepreneurs throughout the world often pursue business ownership either based on opportunity recognition or necessity due to the lack of viable economic alternatives. Consistent with this, research has indicated that minorities are seeking out more entrepreneurial opportunities as a way to overcome the frustration and discontent from the lack of advancement opportunities in large organizations (Weiler & Bernasek, 2001; Heilman & Chen, 2003). These ventures not only benefit individual investors, but also serve to improve overall market efficiency and innovativeness. While these numbers indicate that the entrepreneurial spirit is alive and well internationally, research indicates that many more people have entrepreneurial potential than ever actually become entrepreneurs (Kent, 1990). Of special concern is the degree to which African Americans may experience barriers that limit their potential in the entrepreneurial sector.

Before addressing potential obstacles historically faced by African Americans in regards to business ownership, it first important to understand the importance of entrepreneurship for minority groups. As suggested by Acs, Tarpley and Phillips (1998), a primary contribution of entrepreneurial ventures is to allow minorities to enter the economic and social mainstream of American society. Similarly, past research has argued that the health and growth of African American-owned small businesses often serves as a strong barometer for the overall progress made by minorities in the U.S. (Feldman, Koberg & Dean, 1991; Thompson, 1999).

From a legal perspective, the passage of the Small Business Act has impacted the number of minorities who have considered entrepreneurship as a viable career choice. The Act proposes a relationship between training courses and small business development, which suggests that the actual and potential capacity of small business is encouraged and enhanced by the use of training (Martin, Wech, Sandefur & Pan, 2006). As a result of the governmental and educational initiatives, the number of opportunities for African Americans to receive training and education for small business development has substantially increased over the last three decades. Recent evidence seems to indicate that minority entrepreneurship has steadily increased during the past

decade, with estimations that currently 30% of small businesses in the U.S. are owned by women or minorities (Bergman, 2006). Furthermore, numerous GEM reports extol the importance of involving minorities in the entrepreneurial process as it can play an important role in accelerating the overall pace of entrepreneurial activity within an economy (Reynolds, Camp, Bygrave, Autio, & Hay, 2001).

To date, little research has empirically examined the entrepreneurial attitudes and intentions of African Americans, particularly young adults. In fact, despite their recent increased involvement in business ownership, past research has indicated that minorities tend to be less optimistic overall in their expectations of business success (Carter, 2000), and are more likely to fail when starting a new venture (Carter, Williams & Reynolds, 1997; Boden & Nucci, 2000; Robb, 2002). Thompson (2004) points out that successful entrepreneurship requires a combination of temperament, talent and technique. It can be argued that temperament is first needed in order to convince African Americans of their potential in the entrepreneurial arena, and to encourage them to view business ownership as a viable career option. Thus, a stronger understanding of the entrepreneurial attitudes and intentions of young adults in the African American population can make an important contribution to the entrepreneurship research body.

## Literature Review

The study of entrepreneurship may include consideration of numerous contextual factors, including both environmental and individual characteristics. Past areas of focus for entrepreneurial research have included geographical location, regional policies, access to resources and support programs, family history, educational levels, personality traits, attitudes, ethnicity, and gender. The current study considers two of these individual factors, specifically attitudes and ethnicity.

The work of Robinson, Stimpson, Huefner, and Hunt (1991) was one of the first to incorporate an attitude scale to predict entrepreneurial activity. An advantage of using an attitude approach is that it can be more domain-specific, which increases the correlation with actual behavior and reduces unexplained variability. Attitudes tend to change across time and situations through an interactive process with the environment, and once a person's attitude has been measured, a prediction can be made about the person's future actions (Carlson, 1985). Robinson et al. (1991) developed the Entrepreneurial Attitude Orientation (EAO) model based on the four constructs of achievement, innovation, personal control, and self esteem in business.

Past research suggests that both females (Hisrich & Brush, 1987; Carter, 2000; Thomas, 2001) and minorities (Kourilsky & Esfandiari, 1997; Heilman & Chen, 2003) are faced with more obstacles in the entrepreneurial process, such as less education and business experience, limited resources, and fewer mentors and advisors. In addition, they have greater difficulty obtaining loans (Verheul & Thurik, 2001; Coleman, 2002) and have less of a credit history (Shaw, Carter & Brierton, 2001). Research has also indicated that minorities are less interested in starting a business (Matthews & Moser, 1995; Kourilsky & Walstad, 1997) and when they do it tends to be smaller and more likely to be in the retail or service sectors (Perry, 2002), where failure rates are much higher than other business sectors (Brush & Chaganti, 1999). Robb (2002) and Marlow and Patton (2005) suggests that this occupational segregation may result from the capital restraints faced by many minority entrepreneurs.

In addition to resource constraints, two critical challenges, which may be somewhat linked together, are the skill deficiencies of minority groups in regards to entrepreneurship, and the dearth of role models and mentors available within local communities. Over a decade ago Kourilsky and Esfandiari (1997) noted that although African American youth reported they would like to explore the opportunity of starting their own business, they lacked a strong understanding of basic entrepreneurial knowledge. While the good news is that entrepreneurial attitudes and skills can be developed through entrepreneurship education programs (Robinson et al., 1991; Mitra & Matlay, 2004), research has shown that education and skill differentials can help explain why certain people engage in entrepreneurial activities and are more successful than others (Farmer, 1997; Gatewood, Shaver, Powers & Gartner, 2002; Carter, Gartner, Shaver & Gatewood, 2003).

If Kourilsky and Esfandiari (1997) are correct and skill deficiencies stop minorities from considering business ownership, then the resulting effect can be a limited supply of positive role models for young adults. In fact, research by Heilman and Chen (2003) found a general lack of mentors and mentoring opportunities for potential minority entrepreneurs. Research indicates that a strong support network and a positive relationship with a mentor can help prospective business owners learn the skills needed to successfully operate and manage a small business. Minorities may have fewer opportunities to engage in professional relationships with mentors because of cross cultural differences or the unwillingness of other minority leaders to participate in mentoring relationships (Heilman & Chen, 2003).

The entrepreneurial sector can be an important source of future opportunity for minority groups. Prior research has indicated that the skills and techniques of minorities need more development in order to achieve greater levels of future success. While this is a pressing problem, it is equally important to gain a better understanding of the attitudes of young African American adults toward entrepreneurship in order to determine their future entrepreneurial intentions.

*Historically Black Colleges and Universities (HBCUs)*

A target area for collecting data for this study was students from Historically Black Colleges and Universities. HBCUs have played a crucial role in the rise of black entrepreneurship. These institutions have been "seats of black progress" because of their supportive campus environment and open opportunity structures (Bennett & Xie, 2003). Research on the graduates supported by the United Negro College Fund have reported high levels of satisfaction with HBCUs and have frequently stated that they have prepared "them well for participation in society" (Butler, 1991). It additionally observed that the upward economic and social mobility of HBCU graduates is, in many respects, reminiscent of the experiences of immigrant ethnic groups that have pursued the American Dream through higher education and entrepreneurship (Butler, 1991).

Evaluating the relationship between attendance at HBCUs and those who become successful entrepreneurs reveals two opposing viewpoints. From one perspective, many believe that native-born African Americans have failed to develop a tradition of entrepreneurship for a variety of reasons, most notably the lack of opportunities to gain experience in "buying and selling" (Frazier, 1949), a dearth of business "success symbols" (Foley, 1966), and the absence of a cultural heritage (Light, 1972). Thus, this viewpoint embraces the idea that successful African American businesses is one of a tradition of successful individuals, rather than one based upon a collective experience (Light, 1972).

Another perspective examining the relationship between attendance at HBCUs and entrepreneurship attitudes embraces the view that a small class of mostly Southern blacks has followed a tradition of self-help and entrepreneurship, inspired by the idea, espoused by Booker T. Washington, that they could "take advantage of the disadvantages" of racial oppression (Butler, 1991). This counterargument holds that active participation in the educational, religious, and fraternal organizations of the segregated black communities of the South has been a hallmark of this select group of black entrepreneurs and that attendance at HBCUs has been central to this heritage (Butler, 1991). It suggests that the formation and continued existence of this class – particularly in the South, where blacks have faced their greatest disadvantages – have been tied closely to involvement in the institutions that its members have collectively supported, most notably HBCUs (Boyd, 2007).

## Hypotheses

Despite the discrepancies highlighted in previous literature, we believe the attraction of entrepreneurship will be positive among college-age African Americans. Various GEM reports suggest that ethnic entrepreneurship is on the rise in many regions of the world. While African Americans are disproportionately underrepresented as small business owners in the U.S., the growth rate of African American-owned small businesses is quite high (Martin et al., 2006). In addition, Sriram, Tigineh and Herron (2007) suggest that entrepreneurial opportunities are critically important within the African America community as a means of overcoming the stagnation in our national economy, particularly in urban areas. This leads one to believe that many young African American adults are interested in entrepreneurship and view it as a legitimate career opportunity. As such, we offer the following hypothesis:

H1: African American students will posses entrepreneurial attitudes and intentions that are stronger than those of student entrepreneurs in general.

Past research has established a link between entrepreneurial attitudes and intentions and past business experience and exposure. This may include direct work experience or indirect experience through a family business. Past studies have shown that both work experience with a small business (Peterman & Kennedy, 2003) and a family business (Reitan, 1997) can have a positive impact on perceptions of new venture feasibility and desirability. In addition, Gatewood and Shaver (1991) found that self-confidence and motivation can be affected by experience and past business results. Since research has shown that entrepreneurial attitudes can change (Robinson et al., 1991), prior personal experience or other forms of contact may play a significant role in shaping these attitudes. Therefore, we hypothesize:

H2: Past entrepreneurial experience and exposure to entrepreneurial activities will result in stronger entrepreneurial attitudes for African American students that have experienced them than for those who have not.

## Method

*Participants*

Participants were 93 individuals who were enrolled in business courses during the spring and summer 2009 semesters at several universities in the southeast U.S. The sample was 46% male, with an average age of 25. The participants came from all class levels, with the largest percentage classified as seniors (45%), followed by graduate students (29%), juniors (18%), sophomores (4%) and freshman (4%).

*Measures*

We measured entrepreneurial attitudes with the Entrepreneurial Attitudes Orientation survey instrument (Robinson et al., 1991). The EAO is theoretically well grounded and provides a composite score based on four attitude subscales: 1) Achievement in business refers to concrete results associated with the start-up of a business (Cronbach's alpha = .84), 2) Perceived personal control of business outcomes concerns one's perception of control or influence over his or her business (Cronbach's alpha = .70), 3) Innovation in business relates to acting on business activities in novel ways (Cronbach's alpha = .90), and 4) Perceived self-esteem in business which relates to self-confidence with regard to one's business affairs (Cronbach's alpha = .73). The four subscales have been shown to produce 77% accuracy in predicting entrepreneurship (Robinson et al., 1991).

In addition to completing the EAO, participants provided demographic information including gender, age, class standing, previous exposure to entrepreneurial organizations, and information related to their future entrepreneurial intentions. In order to measure prior exposure to entrepreneurial initiatives, two questions were asked related to this: 1) Has your family ever owned a small business? & 2) Do you currently own a small business or have you ever owned a small business in the past?

*Analyses*

Since the primary interest of the study was to examine differences between our African American student population and the scores of student entrepreneurs used in the original validation of the EAO, t-tests were used to compare the means of each group on each of the attitudes and intentions of interest.

## Results

Hypothesis one was supported in all but one instance; African American students possessed significantly stronger entrepreneurial attitudes than did the EAO's overall validation group. In the one exception, entrepreneurial self-esteem, the African American students were not significantly different, indicating that they possessed comparable entrepreneurial orientation in this arena. Table 1 provides the descriptive statistics for all of the dependent variables of interest - the four entrepreneurial attitudes for the current study. Table 1 also indicates the results of the t-test for differences between our sample and the validation sample used to create the EAO.

Table 1. Means and Standard Deviations for Entrepreneurial Attitudes

| | | Mean | Std. Dev. | t | Mean Diff. |
|---|---|---|---|---|---|
| Entrepreneurial Innovation * | African Americans | 7.10 | 1.02 | 7.78 | .82 |
| | Validation Sample | 6.2 | | | |
| Entrepreneurial Achievement * | African Americans | 8.18 | 1.25 | 11.40 | 1.48 |
| | Validation Sample | 6.7 | | | |
| Entrepreneurial Personal Control * | African Americans | 8.06 | 1.50 | 10.67 | 1.66 |
| | Validation Sample | 6.4 | | | |
| Entrepreneurial Self-esteem | African Americans | 6.62 | 1.68 | -.45 | -.08 |
| | Validation Sample | 6.7 | | | |

*Significant at $p < .05$.

Hypothesis two examined whether or not prior exposure to entrepreneurial activities was associated with stronger entrepreneurial attitudes within the current sample population. This supposition was supported for all entrepreneurial attitudes except entrepreneurial self-esteem. For self-esteem, having exposure via a family business or having one's own business was not associated with significantly stronger entrepreneurial attitudes. Table 2 provides both the descriptive statistics, as well as the results of the significance testing, for this hypothesis.

Table 2. Means and Standard Deviations for Entrepreneurial Attitudes & Prior Exposure

| | Has anyone in your immediate family ever owned a small business? | N | Mean | Std. Dev. | t | Mean Diff. |
|---|---|---|---|---|---|---|
| Entrepreneurial Innovation * | Yes | 44 | 7.26 | .88 | 2.21 | .45 |
| | No | 49 | 6.80 | 1.10 | | |
| Entrepreneurial Achievement * | Yes | 44 | 8.50 | 1.21 | 2.41 | .61 |
| | No | 49 | 7.89 | 1.23 | | |
| Entrepreneurial Personal Control * | Yes | 44 | 8.43 | 1.32 | 2.40 | .71 |
| | No | 49 | 7.73 | 1.59 | | |
| Entrepreneurial Self-esteem | Yes | 44 | 6.95 | 1.68 | 1.84 | .63 |
| | No | 49 | 6.32 | 1.63 | | |
| | Do you own a small business or have in the past? | N | Mean | Std. Dev. | T | Mean Diff. |
| Entrepreneurial Innovation * | Yes | 12 | 7.97 | .71 | 4.69 | 1.09 |
| | No | 81 | 6.88 | .98 | | |
| Entrepreneurial Achievement * | Yes | 12 | 8.98 | .88 | 3.18 | .92 |
| | No | 81 | 8.06 | 1.26 | | |
| Entrepreneurial Personal Control * | Yes | 12 | 9.08 | .92 | 3.74 | 1.17 |
| | No | 81 | 7.91 | 1.51 | | |
| Entrepreneurial Self-esteem | Yes | 12 | 7.15 | 1.66 | 1.18 | .61 |
| | No | 81 | 6.54 | 1.67 | | |

*Significant at $p < .05$.

## Discussion

Given the realities of the current economy, the job market which college graduates are currently entering, and the constant media attention paid to the failings of big business, it is of no surprise that interest in entrepreneurship is growing. In addition, some argue that limited opportunities of career advancement in the corporate world for minorities, particularly African Americans, has made entrepreneurship a more attractive, and viable alternative (Basu & Altinay, 2002; Sriram, Tigineh & Herron, 2007). While research has made significant strides in predicting what factors promote overall entrepreneurial success, less is currently known about why some individuals pursue entrepreneurial initiatives and some do not, and why some groups succeed at higher rates whereas others fail. According to Fairlie & Robb (2008) much is still unknown about why some racial groups are more successful in their entrepreneurial endeavors than others; our examination of the entrepreneurial attitudes of African American business students seeks to provide insight into this phenomenon.

The current economy is highly dependent on small business and entrepreneurship, and this very much includes the enterprises of African Americans. Estimates indicate that there exists approximately one million African American owned businesses in the U.S., which account for over $100 billion in annual sales (African American Entrepreneurs, 2009). In addition, African Americans are 50% more likely than whites to start their own businesses, and 86% of African American teens polled by Junior Achievement expressed interest in starting a business (African American Entrepreneurs, 2009). According to another sample of African American teenagers, their interest in entrepreneurship stems from a desire to be more autonomous and to help others (Wilson, Marlino & Kickul, 2004). These statistics are highly consistent with our findings. The nascent minority entrepreneurs included in the current study were found to have significantly stronger entrepreneurial attitudes than the student entrepreneurs who were originally used to validate the Entrepreneurial Attitudes Orientation Scale.

Our findings with regard to the impact of prior exposure to entrepreneurial activities and its impact on attitudes are also consistent with what is known about real-life entrepreneurship. Other authors have indicated that intergenerational linkages in business ownership are quite strong; some studies indicate that being self employed is much more likely for the children of entrepreneurs (Fairlie & Robb, 2008). In fact, some estimate that more than one half of all business owners had a self-employed family member in their history (U.S. Census Bureau, 2006).

Although not a primary focus of our study, it is important to note the value that entrepreneurship education can play in helping prepare African American students for success in the entrepreneurial world. Research shows that many young adults, particularly aged 25-34, are often interested in new venture creation, and individuals with post-secondary academic experience are more likely to act in an entrepreneurial manner (Minniti, Bygrave and Autio, 2006). This, combined with our results indicating that college-age African Americans already possess strong entrepreneurial attitudes, makes it critical for colleges and universities to offer entrepreneurship programs for young adults interested in business ownership. These programs can not only help them recognize entrepreneurship as a viable career choice, but also equip them with a better skill set for business development. Thompson (2004) suggests that talent and temperament are vital for entrepreneurs, and talent can be improved through participation in educational programs. If you can assess whether or not someone has the temperament to be an entrepreneur, then learning can be “relatively quick and easy” when appropriate training is provided (p. 246).

In general, our findings are likely to be good omens. If one accepts the premise that attitudes are precursors to intentions, and intentions predict behaviors; the current generation of African American business students is well suited to pursue and succeed in the entrepreneurial realm. They have not only the desire to pursue new business opportunities, but also possess the human capital that is gained through education and prior exposure to entrepreneurship that are necessary determinants of success in this field.

## Future Research

Each and every one of us has a vested interest in promoting the success of small business enterprise in the U.S. Minority firms hire more than 4.7 million employees, a disproportionate share of them minorities (U.S. Census Bureau, 2006), and many of these jobs are located in disadvantaged communities. Given the fact that minority owned businesses do not have the same

profitability outcomes of white-owned enterprise, any and all efforts to understand this discrepancy should be undertaken. The current study indicates that one area which should not be an impediment to the current generation of nascent entrepreneurs is their attitudes toward business ownership. However, future research is necessary to identify other areas that might promote entrepreneurship and entrepreneurial success among the African American population. With a better understanding of this, and policy to promote it, the economic standing of all Americans is potentially improved and the small business sector's overall strength is solidified.

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# GENDER DIFFERENCES RELATED TO INITIAL START-UP AND FOLLOW-ON FINANCING IN SMES

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## Abstract

In this paper, the authors will discuss the results of a statistical analysis of gender differences identified from a recent survey analyzing financing options for small businesses, owners attitudes toward different financing options, and real or perceived difficulties encountered in gaining financing for growth. The survey instrument was designed to address two primary aspects of financing within small businesses – availability/use of outside debt or equity funds, and owner attitudes toward various funding options. The instrument was administered to businesses in the Arkansas Small Business and Technology Development Center (ASBTDC) data base. Selected results of the statistical analysis will be presented in this paper.

## Introduction

According to the U.S. Small Business Administration (SBA, 2007), small businesses accounted for all of the net new jobs in the U.S. economy in 2004. Small firms had a net gain of 1.86 million jobs, while large firms with 500 or more employees had a net loss of 181,000 jobs. Small firms employed 50.9 percent of the private sector work force and generated 50.7 percent of the non-farm private gross domestic product.

In addition, about 99.9 percent of the employer businesses fall in the small business category (SBA, 2007). The average (mean) small employer had one location and ten employees, while the average large employer had 62 locations and 3,313 employees. The median employer size was about four employees for small firms and 1,000 employees for large firms.
With such significant economic statistics, gaining a better understanding of small businesses and their opportunities for financing for growth becomes critical to researchers. Without the ability to finance business startups or expansion, entrepreneurs cannot maintain their place as the primary engine of the U.S. economy. With this in mind, the researchers created a survey to provide information on (1) options for financing in small businesses, (2) ownership attitudes towards financing options, and (3) difficulties involved in getting business financing needs met. Both equity and debt financing were reviewed.

This paper is a report on an analysis of a gender subset of the statistical data resulting from the above financing survey. It is a look into what the statistical results from the survey tell us about male versus female-owned client businesses of the Arkansas Small Business and Technology Development Center. In some areas, these analyses continue to provide corroboration of information from both Federal reports and academic analyses. In other areas, however, it appears that the analysis of the survey data contradicts at least some of the national data on small businesses. The authors intend to continue to complete follow-on projects to analyze the survey results in more detail.

## Methodology

In small business development studies, probably the most binding constraint of the researchers is to acquire relevant information about the target population. Due to its relevance and ease of accessibility, we have structured our sampled data from the Arkansas Small Business and Technology Development Center (ASBTDC) client pool. ASBTDC provides a broad variety of consulting services to different client groups, from entrepreneurs in the planning stage to small companies that have been in business for many years. Clients of the center are generally classified into three broad groups: casual clients; clients having training services from the center; and finally small companies getting significant counseling from ASBTDC staff. For our target population, we first chose going-concern companies receiving any counseling services from the center. This created a population of 2807 clients, based on March 2008 records. The authors used a simple random sampling strategy. The sample was further refined by requiring that companies had started their operations at the beginning of 2006 or earlier and that they were still in business at the time of the survey. This created an a priori sample population of 1476 clients.

The authors then developed the Internet survey instrument and placed it on-line with assistance from the Arkansas Small Business and Technology Development Center (ASBTDC). Prior to the release of the survey, three email messages were written and sent to the selected survey population. The researchers provided ASBTDC with text of the email messages and the ASBTDC contacted persons via email regarding the study. The first email was sent a week before the survey was available to potential respondents. The second email was sent when the survey was available and requested that potential respondents complete the survey. The third email was sent the following week as a reminder that the survey was on-line and available for responses.

As required by Institutional Review Board guidelines, potential survey respondents were assured of confidentiality and anonymity. It was also noted that participation was strictly voluntary among those contacted. No incentives of any kind were offered by the researchers or ASBTDC for participation in the survey. The researchers are unaware of the identities of the respondents and are not personally involved with any respondents to this study.

After collecting the data, the respondent pool was revisited. Cases where there were duplicate respondents from the same company were sorted and the primary respondent was retained. Between these duplicates and bounced e-mails, 173 of the potential client population (equal to 11.7% of the total clients sampled) were removed from the a priori sample population. A total of 162 survey responses were collected from the 1303 remaining valid e-mails, which equates to a 12.4% response rate.

The ASBTDC is composed of the central state office in Little Rock, and six satellite offices throughout the state. The target list of respondents was collected from the client data base of all seven offices. The authors understand that constructing a sample from ASBTDC clients probably creates a “survivor bias” in our population. Surveying ASBTDC clients, who presumably benefit from ASBTDC training and counseling, likely means the survey sample is more successful than the population of “all business startups”. However, this inherent bias does not mean that the data collected is not valuable in helping researchers to understand the financing methods used and the financing options available to SMEs. In fact, it could be argued that

because the sample population has in some form been successful, that the information provided could be more valuable to individuals considering a new business startup or growth financing options in their existing business.

Survey respondents were asked to review and complete a 28-item survey instrument. Items one through four asked about founders' ownership of, and allocation of equity within, the firm. Items five, seven and eight asked questions related to the owners knowledge level concerning business financing as well as their financial contributions to the business startup. Items nine through eighteen address information items on external funding for the firm. Item 21 asked the respondent to provide data on the company's current capital structure. Items 19, 20 and 22 to 24 deal with owner attitudes toward funding options for the firm, both historical funding and potential future resources. Item 25 requests information on purposes for previously received debt or equity funding, while item 26 asks about plans for raising additional capital. Finally, items 6, and 26 through 28 asked the owners about their use of business planning and whether they had used a business plan for raising funds in the past.

In each of the questions, the authors subjected the response data to chi-square testing, breaking down the responses by gender. Questions where the responses differed significantly by gender are noted in the Discussion section of this paper.

## Discussion

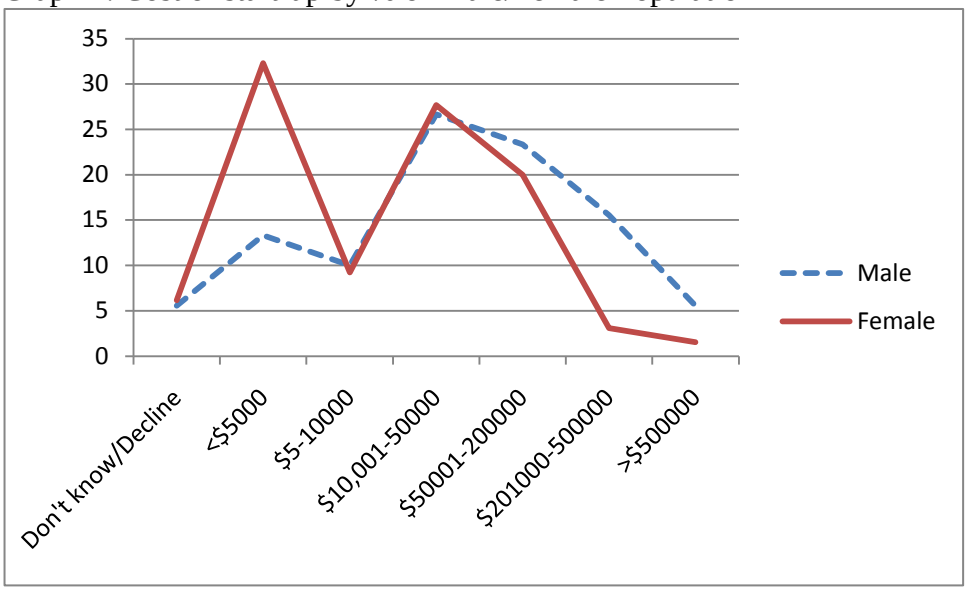
Broadly speaking the survey instrument from which this paper is derived was designed to analyze the financing structure in companies within a specific geographic region by tabulating the results obtained from a recent survey. The ASBTDC maintains coding within its customer database that allows them to complete statistical analyses based on a large number of demographic variables. For the purposes of this paper, the authors chose to analyze the difference in responses based on the gender of the primary business owners in our sample. Highlights from this analysis are shown in the following sections.

The first differences based on gender begin to come to light in questions 5, 9 and 10, which provide introductory statistics representing the financial structure of the population companies. Information on initial investment and current capital structures can be seen in figures 1, 2 and 3 below (based on questions 5, 9 and 10). In each of these three questions there was a significant difference between the male and female population in the survey.

Survey question 5 requested that respondents provide information on actual business startup costs, and the surveyed population (see graph 1 below) shows significantly different results (chi-square $p<0.04$) between the male and female subgroups, with male owned firms having significantly higher start-up costs, in line with Robb and Coleman (Robb & Coleman, 2009). There is much speculation concerning the reasons for the lower cost of female-owned businesses in the research literature. Robb and Coleman (Robb & Coleman, 2009) note that women-owned businesses tend to be "smaller and less growth oriented than men-owned firms" and that a "higher percentage of women had 'low' business credit scores" in their research. Verheul and Thurik (Verheul & Thurik, 2001) and (Aurenius & Autio, 2006) both break out what they refer to as an "indirect" gender effect, noting that women run businesses in different sectors/industries, pursue different goals, are more likely to run their businesses part-time and strructure their

businesses differently than men. In their work, Robb and Coleman (Robb & Coleman, 2009) also conclude that "… women may place less value on firms size and profits than do men-owned firms. Alternatively, women may have a higher level of risk aversion for the perceived risks associated with firm size, growth, and a possible loss of control."

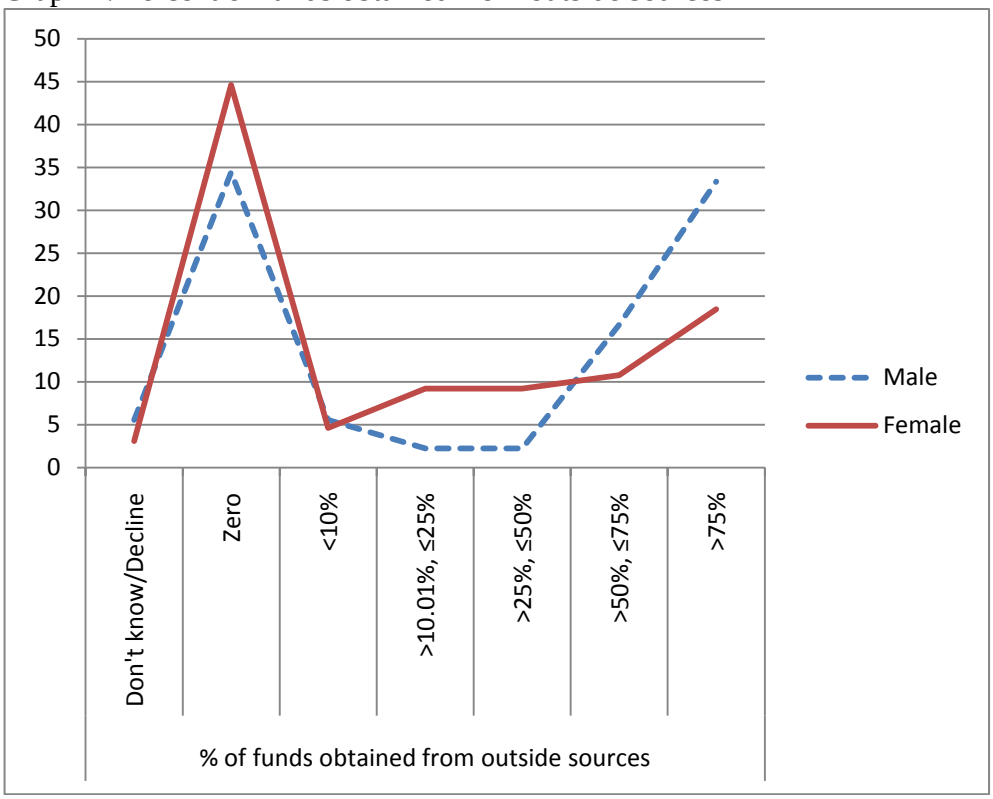
Graph 1: Cost of start-up by % of Male/Female Population




Survey question 9 begins to break down Start-up Capital between internal and external funding sources when it asks how much of the total funds required to start the business were obtained from outside sources. While the overall population in the study falls reasonably in line with Cassar's findings (Cassar, 2004) of 40.2% of startup capital coming from external sources (our results show a mean of 35.8%) this question again shows a significant difference (chi-square, $p<0.05$) between the male and female populations (see graph 2 below) in the study. In this case, the female population requested and received significantly smaller amounts of outside capital in starting their business.

Again, this may be the result of a propensity for risk aversion in the female population surveyed. Cassar (Cassar, 2004) notes that information asymmetries exist between the firm and its potential financiers. "The greater the exposure to the risk associated with the information a symmetries… the higher the return of capital demanded by each financing source (Cassar, 2004)". Therefore, because of the risk aversion noted in female business owners by Robb and Coleman (Robb & Coleman, 2009) and (Cassar, 2004) among others, it would be expected that we would see lower levels of external startup capital.

Graph 2: Percent of funds obtained from outside sources

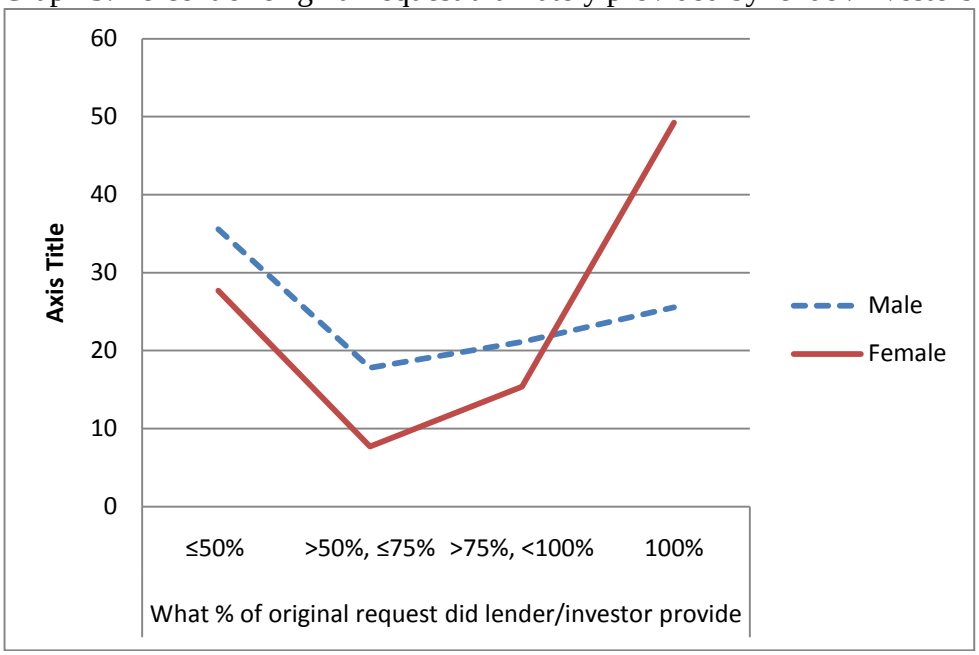



Survey question 10 asked how much of the requested external financing was ultimately provided to the business startup. Here again, we see significant differences ($p<0.02$) between the male and female population. In this situation, the male business owners received less of the requested funding (see graph 3) than did the female business owners. These results fall in line with Irwin and Scott (Irwin & Scott, 2006), which notes that in their survey, males were more likely to have had difficulties raising funds than their female counterparts. There are several possible reasons for this issue.

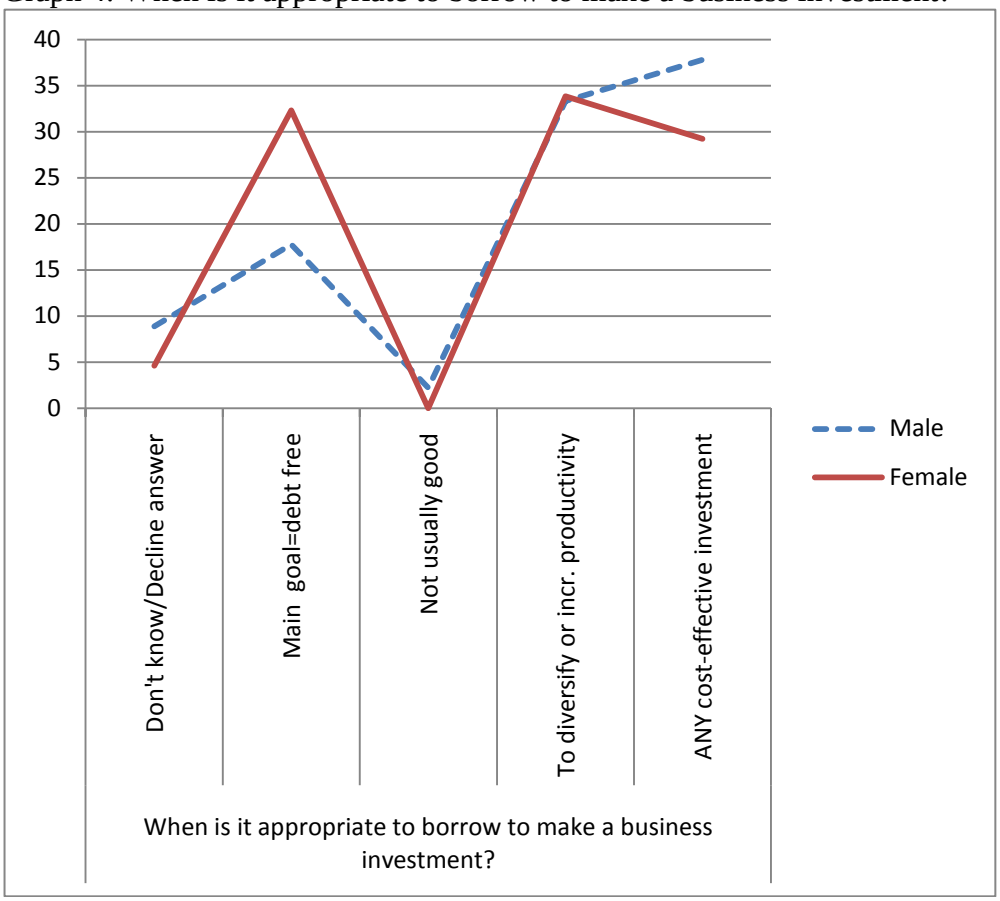
As noted in a previous conference proceeding (authors), "There is also some *preliminary* evidence supporting Brewer et.al. (Brewer III, Genay, Jackson Jr., & Worthington, 1996) that the smallest firms in our sample are 'more likely to obtain debt than non-debt (equity)' financing", and as noted earlier in this paper, female-owned businesses tend to be smaller than male-owned businesses for a number of reasons. It is possible that this has a bearing on the higher levels of debt financing received by the female-owned companies in our sample. However, more analysis needs to be completed before this relationship can be confirmed.

Also noted in the above proceeding (authors), "almost one-third of the entire respondent group indicated they went forward with their business venture with less than half of the capital requested. Further study of this subgroup might provide more useful insights into the attitudes toward outside financing in entrepreneurial groups."

Graph 3: Percent of original request ultimately provided by lender/investors



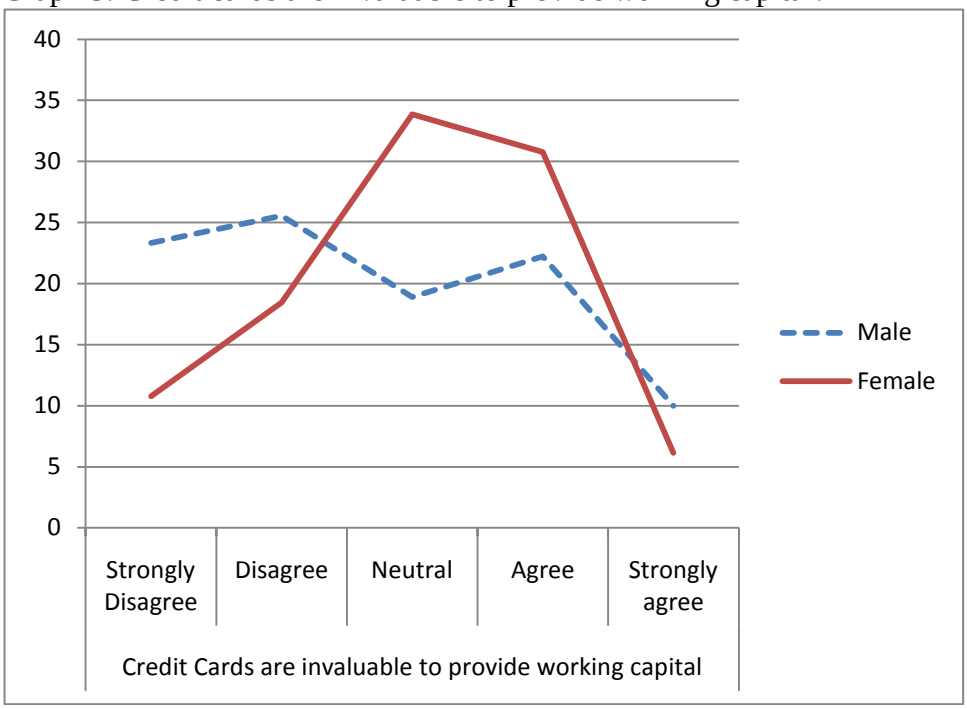

Graph 4: When is it appropriate to borrow to make a business investment?



Questions 20 and 22 were two of the survey questions dealing with owner attitude toward financing of their business. Question 20 provides the next item for discussion in our survey (see graph 4 above). Here respondents were asked when it would be appropriate to borrow money to make a business investment. While the question does not differentiate between the male and female subgroups to a statistically significant degree, one of the answer choices provided interesting contrast between the male and female populations. The answer choice “my main goal is to remain debt free" was chosen by only 17% of the male population, but 32% of the female population identified this is their primary goal. Could this again be the result of a propensity for risk aversion in the female business owners? The remainder of the answer choices within question 20 were much more similar between the two populations.

The last of the questions to show a significant difference between the male and female populations in the survey was question 22 (see graph 5 below). This question stated "Credit cards are an invaluable way to provide my business temporary working capital". The analysis of the question shows that the male population was much more disagreeable with this statement than the female population in the study. While 44 of the 90 male respondents (48.8%) either disagreed or strongly disagreed with this statement and only 29 (32%) agreed or strongly agreed, only 19 of the 65 female respondents (29.2%) disagreed or strongly disagreed with the statement and 24 of 65 (36.9%) strongly agreed or agreed. A question for further research would be “how does the commonly accepted aversion to risk in female business owners reconcile with these results?”

Graph 5: Credit cards are invaluable to provide working capital?




In an interesting side note to this question, less than 33% of the overall population agree or strongly agree that credit cards are a valuable means of providing temporary working capital, while over 40% disagree or strongly disagree. However, when reviewed in light of question 11 of the survey, which asks what types of financing the owners have received over the life of the

business, in line with Mach and Wolken (Mach & Wolken, 2006) nearly 44% of the respondents said that they had used credit cards for financing of the business. There is a discontinuity here between the opinions of the surveyed population and their actions.

We then divided these responses down between the male and female populations in our sample and found that, of the male population 40% had used credit cards for business financing and 50.8% of the females had used such credit. However, when you begin to look at the information contained in these two questions, we find that the *opinion* bias against credit cards in question 22 doesn't match up very well with the *actual use* of credit cards in organizational financing (48% of males either strongly disagree or disagree with using credit cards in question 22, but 40% have used them in financing their business while 36.9% of the females agreed or strongly agreed with credit card use, but more than 50% of the group used them in financing their own firms). However, in both male and female subgroups, we did see some evidence for the "pecking order" in firm financing noted by (Myers & Majluf, 1984), (Watson & Wilson, 2002) and (Ou & Haynes, 2006). The evidence presented by Ou and Haynes (Ou & Haynes, 2006) specifically shows a preferential order in borrowing from "internal sources to traditional lenders to nontraditional lenders".

## Implications for Future Research

There are a number of possibilities for future research based on the results of this survey. Analysis of the correlation between firm size and funding type (for example, credit card use, bank loans, etc.), and for part-time vs. full-time businesses might provide useful information for both owners and potential lenders. Another area of research interest would be attempting to determine reasons for the higher incidence of credit card use in the female population, considering the overall evidence in this and other research showing higher risk aversion in this group.

The authors' future research will continue to break down the survey data in an attempt to identify correlational relationships and to gain a better understanding of SME financing. The authors' intent in administering the survey was to evaluate both the ability of the respondent population to obtain necessary organizational financing and their attitudes toward various financing options. Further analysis of the information contained in the study should provide the small business community with valuable information concerning financing for their businesses. Additional opportunities may be available through providing the survey instrument to researchers in other geographic locations in order that they may duplicate the research and compare results to our findings. Such comparisons could show, despite the survivor bias evident in the ASBTDC sample, that some financing options may be more readily available as well as more acceptable to the small business community than others. Comparison studies might also illuminate regional differences regarding both availability of financing and owner preferences concerning firm financing options.

## Summary and Conclusion

The primary purpose of this study was to gain a better understanding of the knowledge and the practices of small businesses in financing their operations, both startup and going concerns. Some of the preliminary evidence from the survey verifies other existing research, such as average number of SME owners and standard sources of financing - both internal and external.

(As an example, it appears that commercial banks continue to be significant sources for small business growth funds.) However, this survey went further in trying to identify the owners' attitudes towards funding options, their outside investors, and their financing options.
In general, the survey results would seem to imply that female SMEs are still more risk averse than their male counterparts when it comes to financing of their firms, although the one issue that stands out in contrast to this statement would be the greater use of credit cards by the female business owners. Further study concerning the attitudes about, and reasons for, credit card use would add to the body of information on small firm financing.

The resulting information from the survey questions will provide the authors with rich continuing research opportunities concerning SME financing. With the knowledge gained through this research we hope that more specific guidance can be provided to owners and managers of small businesses concerning both methods and options for financing future growth.

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# SPA SUCCESS REQUIRES SERVICE QUALITY AND PLANNING

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## Abstract

Spas come in all shapes and sizes. Some spas cater to weary travelers at airports. Others dispatch masseuses to local businesses during stressful times. Still others offer organic body treatments or provide Botox injections during a visit to a mall. Despite these variations, spa success depends on the crafting of a pampered environment for guests. The delivery of treatments, in turn, relies on friendly, trustworthy and skilled personnel. It would make sense for spa owners to use sound human resource (HR) practices to ensure service quality. This study found significant positive relationships between spa size (i.e., facility square footage) and profits (i.e., net profit as a percentage of gross revenues) and between spa amenities (e.g., locker rooms, quiet areas, saunas, refreshments) and profits (i.e., net profit as a percentage of gross revenues). The positive relationship between convenience (i.e., number of treatment rooms) and profits (i.e., net profit as a percentage of gross revenues) approached significance. This study also found that those spas that implemented more than one HR planning process were larger, more convenient, and offered more amenities compared to those that implemented only one HR planning process and compared to those that did not implement any HR planning processes.

## SPA Success Requires Service Quality and Planning

From 1999 to 2008, the number of spas in the US grew from 5,689 to 21,300, according to the International Spa Association, while revenues jumped from $5 billion to $12.8 billion over the same time period ("ISPA Releases," 2009; McNeil & Ragins, 2005). The spa industry is fragmented, with the majority of spas operating as single unit facilities ("Day Spas," 2002). The barriers to entry are low and there has been a rapid expansion of competition. Porter, as noted by Ormanidhi and Stringa (2008), suggests that when there are substantial competitive pressures in an industry, businesses should strive to create an identifiable differential advantage. Certainly up to the market crash in September 2008, the growth of the day spa industry was spectacular.

Day spas and medical spas have evolved as customer care was extended from beauty, hair and cosmetic salons/stores and from physicians' offices (Crebbin-Bailey, 2007; "The Facts," 2006; Predmore & Greene, 2007). Beauty spas have sought to offer additional services to their customers that would enhance the salon experience while medical spas have sought to diminish the clinical and perhaps, fearful, atmosphere of a doctor's office while delivering medical cosmetic enhancements. Selden and MacMillan (2006) have suggested, "moving a company beyond its core [market] segment" by adding either new consumer goods/services to the extant goods/services of the company or adding new consumers to its customer base, especially when faced with increasing competition.

Spas seem to be following this advice as more facilities continue to enter the industry and offer more services, amenities and procedures (Wells, 2009). Of the 328 day spas and the 106 medical spas included in the 2002 survey by The Day Spa Association (DSA), many had extensive services that could be used by consumers/clients and products available for purchase to extend the spa experience to the home environment. By offering these expanded product services, the spas are trying to create an identifiable differential advantage.

Within the spa experience, customer service and pampering is critical to having the consumer experience a spa at its best. "Complacency is a forerunner to disaster in the turbulent marketplace," (Cravens & Shipp, 1991). Additional ways spas could create identifiable differential advantages would be to provide more service professionals so that each consumer has a personal care assistant to make sure that all of the services are provided on time, escort the client through the grounds of the spa to reduce the possibility of losing track of clients and to ensure that nearly every whim is satisfied or possible service provided. Increased concern for the mental and physical comfort of the consumer/client is pushed beyond what might be expected within a local region by the larger number of people who experience spas while away from home – on business or vacation - so that spas in Dubai or Japan may serve as comparisons to the spa services delivered at home (Wells, 2009).

While extending products, services and/or procedures is laudatory in creating a differential advantage to succeed in a competitive environment, a corollary action is to implement good human resource (HR) practices. In many small businesses, unfortunately, there is no plan for training; no plan for evaluating procedures, staff or services; and even no strategic plan for the future. Davidson (2009) posits that a small business adds layers of management and strategic planning to control the additional chaos that more people and structures bring in a business life cycle pattern. However, some businesses remain relatively small for many years, with only one location in a retail/service site. Then they become aware of an opportunity in a nearby location and jump to take advantage of it. With the opening of an additional facility comes increased business operations and responsibilities. The older style of dealing with issues/problems as they arose no longer works. Creating some processes and procedures for handling the commonalities between the two locations leads to planning of some form. It may be that as a small business increases the amount of planning to maintain high quality service providers, it moves closer to creating a strategic plan while growing from a small to a medium sized business.

In its 2002-benchmark survey, the DSA asked its spa members questions about possible sources for a differential advantage. How large was their spa? How many treatment rooms did they have? What types of amenities did they offer? Members were also asked if they designed and trained step-by-step protocols for each service and if they had a formal review process for staff on a regular basis. The spas' responses indicated some level of HR planning ranging from the deployment of no HR processes to the deployment of one HR process to the deployment of two HR processes. As each small business owner initiates planning instead of reacting to crises, the business begins to enter managerial control systems rather than using individual preferences or emotional responses to business situations.

## Hypotheses

In this study, the relationships between spa size, spa convenience and spa amenities and between spa profits are explored. It was felt that larger spas that have more convenient facilities and offer extra amenities are more luxurious and therefore, more likely to attract customers which will enhance their profitability than smaller spas offering less convenience and fewer amenities. The role that HR planning practices play in differentiating spas in terms of their size, convenience and amenities is also an important research question. It was believed that those spa owners who seem to care about training and evaluating their staff on a regular basis are better equipped to manage a larger facility, to offer greater convenience and to provide more amenities than those who seem to care less, or do not seem to care at all about training and evaluating their staff on a regular basis.

The following hypotheses were developed:

H1: The larger the spa, the higher the profits.

H2: The more convenient the spa facility, the higher the profits.

H3: The greater the amenities offered by the spa, the higher the profits.

H4: Spas that use two HR planning processes are larger compared to spas that use none of the HR planning processes and compared to spas that use only one of the HR planning processes.

H5: Spas that use two HR planning processes are more convenient compared to spas that use none of the HR planning processes and compared to spas that use only one of the HR planning processes.

H6: Spas that use two HR planning processes offer more amenities compared to spas that use none of the HR planning processes and compared to spas that use only one of the HR planning processes.

H7: Spas that use two HR planning processes realize higher profits compared to spas that use none of the HR planning processes and compared to spas that use only one of the HR planning processes.

## Methodology

Data for this study came from a larger research project, *The Day Spa Benchmark Survey* (Williams, undated). It was designed by the DSA in 2002 so that its spa members could compare their facilities, profits, protocols and challenges with those of other spa members. The study relies on self-reported data. The DSA posted its survey on its web site and invited members to complete the questionnaire. Participants were offered weekly drawings for prizes from the Association. There was no personal contact and there was certainly some self-selection bias as there was no control over who answered the survey. The questionnaire was completed by 496 respondents who classified their facilities as day spas, medical spas, resort spas, hotel spas, destination spas or other types of spas.

The size of the spa was measured by a survey question asking spa members to indicate the square footage of their facility. Responses ranged from under 1,500 square feet to over 6,000 square feet. With the possible future inclusion of even more luxurious spas, that upper boundary will continue to grow as many vacation destinations have built very large spas in recent years. Dubai is home to a luxury day spa with 24,000 square feet in one location (Wells, 2009).

Convenience was measured by a survey question asking spa members how many treatment rooms or treatment stations they had. The higher the number of rooms/stations, the greater the convenience since customers would not have to wait long for services. Also, a greater number of customers could be treated simultaneously. The number of treatment rooms varied from two or more to over twelve and again this upper boundary number would likely be much greater now with larger spas having been built.

Amenities were calculated by adding up the number of amenities that spa owners checked off in the questionnaire. Amenities ranged from providing locker rooms for storage of clothing to steam rooms, saunas, hot tubs, quiet rooms and beverage services.

Profitability was measured by asking spa members to report their approximate net profit as a percentage of gross revenues. Responses ranged from "not profitable yet" to over 15%.

Spa members were asked two questions regarding their HR practices. They answered, "yes," or "no" to the questions: "Do you design and train step-by-step protocols for each of your services?" and "Do you have a formal review process for your staff on a regular basis?"

## Results

The statistical package, SPSS, was used to analyze the data. One-tailed Pearson correlation analyses were run to examine the extent of the relationships between spa size, spa convenience, spa amenities and between spa profits. Results show that there was a significant positive relationship between spa size and spa profits ($r = .12$; $p = .01$). There was also a significant positive relationship between spa amenities and spa profits ($r = .12$, $p = .01$). There was marginal support for the relationship between spa convenience and spa profits ($r = .07$, $p = .07$). Strong support was found for hypotheses H1 and H3 but not for H2.

The means for spa size, spa convenience, spa amenities and spa profits were compared according to the presence and number of HR planning processes that spa owners used in their businesses. Here, a two-step procedure was used. First, analysis of variance was used to ascertain if there were overall mean differences among groups of spas that had (a) both step-by-step training protocols for services and a formal review process for staff, (b) either step-by-step training protocols for services or a formal review process for staff and (c) neither step-by-step training protocols for services nor a formal review process for staff.

Second, Duncan's multiple-range tests were performed on all pairs of means in the spa groups, which were classified in terms of the number of HR planning processes used (none, one, or two). This was necessary since the results of the ANOVA only indicate whether or not at least one group mean is statistically different from another group mean. We wanted to learn if all three group means were different or if the means of just two groups were different (and if the latter, which two group means were different).

Table 1 shows the results from the ANOVA. There were significant differences in the means of at least two of the spa groups as categorized by the number of HR planning processes for spa size, spa convenience, spa amenities and spa profits.

Table 1. Assessment of Spa Facilities by Number of Planning Processes

| | | Sum of Squares | df | Mean Square | F | Sig. |
|---|---|---|---|---|---|---|
| 1. Spa size (square footage of facility): | Between Groups | 27.808 | 2 | 13.904 | 14.638 | .000 |
| | Within Groups | 449.291 | 473 | .950 | | |
| | Total | 477.099 | 475 | | | |
| 2. Spa convenience (number of treatment rooms/stations): | Between Groups | 28.552 | 2 | 14.276 | 10.580 | .000 |
| | Within Groups | 639.578 | 474 | 1.349 | | |
| | Total | 668.130 | 476 | | | |
| 3. # of amenities: | Between Groups | 40.980 | 2 | 20.490 | 12.296 | .000 |
| | Within Groups | 741.511 | 445 | 1.666 | | |
| | Total | 782.491 | 447 | | | |
| 4. Spa profits (net profit as a percentage of gross revenue): | Between Groups | 41.553 | 2 | 20.777 | 3.109 | .046 |
| | Within Groups | 3113.683 | 466 | 6.682 | | |
| | Total | 3155.237 | 468 | | | |

Table 2 shows the results for spa size using Duncan's multiple-range test. The mean square footage for the spas that did not use any HR planning processes and the mean square footage for the spas that used either training protocols or formal review were not statistically different from one another (1.95 versus 2.05). However, the mean square footage for the spas that used both training protocols and formal review were statistically different compared to the means for square footage for the spas in the other two groups (2.51 versus 1.95 and 2.05). Thus, the spas that had both training and formal review processes were significantly larger than those that had either type of HR planning process and no HR planning process. This supports hypothesis 4.

Table 2. Spa Size (square footage of facility)

| | If a spa had both training protocols and formal review | N | Subset for alpha = .05 | |
|---|---|---|---|---|
| | | | 2 | 1 |
| (a, b) | No | 61 | 1.95 | |
| | One Yes and one No | 124 | 2.05 | |
| | Yes | 291 | | 2.51 |
| | Sig. | | .463 | 1.000 |

Means for groups in homogeneous subsets are displayed.
a=Uses Harmonic Mean Sample Size = 107.549.
b=The group sizes are unequal. The harmonic mean of the group sizes is used. Type I error levels are not guaranteed.

Those spa owners who answered, "yes" to both training protocols and formal review had significantly more rooms/stations to offer client services resulting in greater convenience than those that did not use training protocols and did not use formal review (3.10 versus 2.43) and than those that used one HR planning process (3.10 versus 2.74). Also, those spas that had one type of HR planning process had significantly more rooms/stations than those that did not have training protocols and did not have a formal review as shown in Table 3 (2.74 versus 2.43). Hypothesis 5 was supported.

Table 3. Spa Convenience (number of treatment rooms/stations)

| | If a spa had both training protocols and formal review | N | Subset for alpha = .05 | | |
|---|---|---|---|---|---|
| | | | 2 | 3 | 1 |
| (a, b) | No | 61 | 2.43 | | |
| | One Yes and one No | 124 | | 2.74 | |
| | Yes | 292 | | | 3.10 |
| | Sig. | | 1.000 | 1.000 | 1.000 |

Means for groups in homogeneous subsets are displayed.
a=Uses Harmonic Mean Sample Size = 107.594.
b=The group sizes are unequal. The harmonic mean of the group sizes is used. Type I error levels are not guaranteed.

Table 4 shows that the means for all three groups were significantly different from one another. The mean number of amenities offered by spas that used training protocols and formal review was significantly greater than the mean number of amenities offered by spas that did not use any HR planning processes (3.15 versus 2.25) and greater than the mean number of amenities offered by spas that used one HR planning process (3.15 versus 2.77). Also, the mean number of amenities offered by spas that used one HR planning process was greater than the mean number of amenities offered by spas that did not use any HR planning processes (2.77 versus 2.25). Hypothesis 6 was supported.

Table 4. Number of amenities

| | If a spa had both training protocols and formal review | N | Subset for alpha = .05 | | |
|---|---|---|---|---|---|
| | | | 2 | 3 | 1 |
| (a, b) | No | 55 | 2.25 | | |
| | One Yes and one No | 115 | | 2.77 | |
| | Yes | 278 | | | 3.15 |
| | Sig. | | 1.000 | 1.000 | 1.000 |

Means for groups in homogeneous subsets are displayed.
a=Uses Harmonic Mean Sample Size = 98.443.
b=The group sizes are unequal. The harmonic mean of the group sizes is used. Type I error levels are not guaranteed.

Lastly, spas that had both types of HR planning processes had higher reported mean profits than spas with only one type of HR planning process and spas with no HR planning process (4.32 versus 3.72 and 3.68). Duncan's test was significant, however, at the .1 level and not the .05 level. The spas with either training or formal review processes were not significantly more likely to have greater reported mean profits than spas that did not use HR planning processes (3.72 versus 3.68) as seen in Table 5. Minimal support was found for hypothesis 7.

Table 5. Net profit categories as a percentage of gross revenue

| | If a spa had both training protocols and formal review | N | Subset for alpha = 0.1 | |
|---|---|---|---|---|
| | | | 2 | 1 |
| (a, b) | No | 60 | 3.68 | |
| | One Yes and one No | 124 | 3.72 | |
| | Yes | 285 | | 4.32 |
| | Sig. | | .923 | 1.000 |

Means for groups in homogeneous subsets are displayed.
a=Uses Harmonic Mean Sample Size = 106.232.
b=The group sizes are unequal. The harmonic mean of the group sizes is used. Type I error levels are not guaranteed.

## Discussion and Future Research

Results of our data analysis indicate that the larger the spa, the higher the profits and that the greater the number of amenities offered, the higher the profits. Reverse causality is possible. It may be that because a spa has a higher profit, it is able to use its funds more readily to expand its facility and offer more amenities than a spa that has a lower profit.

The results also show that, at a minimum, HR planning processes form a hierarchy of success. The greater the number of HR planning processes, the larger the spa, the greater the convenience offered in terms of number of treatment rooms/stations, and the more amenities offered to clients. The use of a greater number of HR planning processes does not necessarily result in higher profits. It is likely that other factors affect profitability in a spa. Spa owners may need to incorporate additional HR planning processes into their usual management of the spa facilities to ensure high quality and consistent service over time and across location. They may need, for example, to be more selective when recruiting new staff members and to offer better rewards to employees who demonstrate service excellence. Spa owners may need to prepare better advertising and marketing strategies.

The next step is to ask, as former NYC mayor – Ed Koch – was fond of asking, "How am I doing?" It is important to ask that question of customers so one can understand their needs and wants and to evaluate how closely one can come to satisfying those needs and wants. We are currently conducting research on the relationship between client satisfaction and spa profits. This should further help spa owners to develop differential strategies. Future research should expand the hierarchy of HR planning to see if strategic planning creates an environment for spa facility growth or if the growth generates a need for more strategic planning in order to control the intensifying levels of activity in the business. There are opportunities to examine the impact that goal setting, use of financial resources, and market research have on spa success.

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# AN EXAMINATION OF CHINESE ENTREPRENEURS AND INTRAPRENEURS: HIGH TECH OR HIGH TOUCH CUSTOMER SERVICE?

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## Abstract

This study examines customer service among high tech Chinese entrepreneurs and intrapreneurs in the health care and hospitality industries. This research explores the need to address anticipated employees' behavioral response when customer service is introduced into an organization and an incentive system that may or may not be incorporated in the organization. We discuss how total quality management can improve an organizations' main resource – its employees, and how to maintain improvements in customer service (Tesch & Levy, 2008). This research examines the traits of the Big Five Personalities (Korzaan and Boswell, 2008) concerning attitudes and personalities of agreeableness, conscientiousness, emotional stability, extraversion, and openness to experience and examines customer service levels among Chinese entrepreneurs in the high technology, health care, and hospitality fields.

## Introduction

To compete in the global marketplace, organizations must provide exceptional customer service. However, customer satisfaction and attitudes can change rapidly, sometimes on a daily basis. For instance, associates that work in call centers are expected to have pleasant voices, polite demeanor, and have a desire to listen to the customer's needs and concerns. With many organizations employing those with diverse backgrounds functioning in customer service positions, consistency of performance can be a challenge.

Customer service is an integral part of everyday encounters. When we go for our morning coffee, we expect the employee to provide cheerful, helpful service in filling our order. When we visit a retail store to purchase gifts for special occasions, again we depend on store associates to assist in providing suggestions and completing the final purchase process. Good customer service performance begins once the customer enters the organization and should continue until the sale is closed and even after the sale with a phone call in certain instances, such as large ticket items such as automobiles or appliances. However, oftentimes sales associates do not share the passion to provide customer service. Instead, employees commonly lackadaisically stand around and not acknowledging the customer. However, collecting their paycheck is important. Organizations need to determine if poor customer service behavior is due to a lack of training or if there is an attitude problem that will be difficult to change (Holdeman, Aldridge, and Jackson, 1996). "The best marketers of a facility are its own employees- those who feel recognized and appreciated for their contributions toward the facility's success" (Stahl, 1997, p.25).

Managers within an organization frequently overlook the fact that there are at least two types of customers. First, there are internal customers-those who work within the company. Customer service is imperative to the internal organization. New hires maintain the quality and commitment of the organization when they make decisions that affect other employees and the organization (Stahl, 1997). There should be written, visible, and understandable standards of

ethics and behavior, including a code of conduct, and what the organization holds up as behaviors to emulate and those behaviors that are not acceptable. Additionally, the employee guidelines should stipulate the disciplinary steps that will be taken with employees when undesirable behaviors or actions occur.

Unfortunately, hearsay, behind the door whispers, and sometimes physical encounters within organizations are all too common (Longenecker and Meade, 1995). These types of actions are not acceptable in an organization and managers must address these issues in order to boast camaraderie within the organization and have an open, positive environment and culture. If customer service fails internally, managers should quickly find out who caused the conflict, why the conflict happened, and what can be done to eliminate adverse internal customer service. Managers should encourage their employees to be supportive of one another, take initiative to assist when asked, and take responsibility to develop solutions to problems that may arise within an organization (Birkinshaw, Hamel, and Mol, 2008). Oftentimes, international professional service firms are hired to assist in these initiatives, both to address internal as well as external customers, including government clients that are often overlooked (Simon and Welsh, 2009).

Second, there are external customers-those that do not work for the organization, yet have a great impact on the success of the organization's profits, sustainable longevity, and reputation for social conscientiousness. Many customers who patronize service organizations are not receiving the services they expect or deserve. Many service employees lack the skills, motivation, or concern to interact with customers. Organizations have resorted to mystery shoppers to audit their employees and to monitor standardized processes. Organizations will have a customer or someone posing as a customer who expresses a complaint, asks challenging questions, or makes a non-routine demand of some kind (Martin, 2000). While there is room for argue as to how each situation should be handled, guidelines and actions will vary, but the important issue is whether employees take responsibility and ownership of the concern that customers have (Martin, 2000). Studies at Southeastern and Midwestern recreational facilities in the United States found that only 64.4 percent of these employees thanked the customer, 17.2 percent made positive remarks or suggestions, and only 20.7 percent asked or encouraged the customer to return to the facility again (Bower and Martin, 1990). In this case, educational programs that demonstrate positive interactions with customers who are dissatisfied, irate, and sometimes reserve in demeanor may be the key. However, not all programs fit all employees, but gathering information through mystery shoppers and customer surveys that show the level of customer service satisfaction and commitment by employees can begin improvement in the employees' customer service with customers and ultimately perceptions of the organization by customers. Wal-Mart now asks the customer to respond yes or no when using a credit card if the cashier greeted them pleasantly.

## Customer Service Expectations

Not all employees purposely ignore customers; however, some employees may have the training or the knowledge on what to say to customers to delight them. Customer service employees who customarily interact on a daily basis with customers should have ample to say if they are truly service- oriented (Martin, 2000). Studies have shown that quality perceptions of customer service are quite different between small firms and their customers (Roper, Hewitt-Dundas and Mcferran, 1997). Many employees put forth efforts to satisfy customers daily by greeting the customer as they walk in their areas or organization. Is it probable that the expectation levels of customers are too high? Do customers expect the perfect employee to greet or assist them each and every service encounter? Some customers' expectation may be too extreme. This is often

attributed to the "me" society we live in, particularly those born from 1960 on. When multiple customers walk into an establishment, it is hard for employees to handle more than one customer at a time. Many have been trained to remember they can only serve one customer at a time effectively. Nonetheless, there are customers who are impatient, in a hurry, and even rude. Again, these types of customers have high expectations from the organization and its' employees. Generally speaking, it has been found that customers' unreasonable behavior is inversely related to customer satisfaction, which in turn influences the way the customer will behave (Eshgi, Houghton, Teebagy, and Topi, 2006). These customers have a higher tendency to report a problem with a company's product or service. When the perfect encounter becomes the standard for customers' expectations, service providers must meet the challenges of service to the customer at any cost or the organization should consider training programs for its employees to enable them to better respond to adverse situations (Schroer, 2003). Is it up to management and its staff to decide what services are offered and level of customer service demands that are acceptable and when these demands are outside the realm of reasonable business practices (Schroer, 2003). What is reasonable service practices can be addressed in multiple ways and should involve the input on management, staff, and customer service employees. The minimum solution is posted signage and management contact information that is clearly displayed in conspicuous places at the organization for customer compliments or complaints.

## Quality Management in Service

Total Quality Management (TQM) is a well-known approach for endlessly improving the quality of every facet of business life and the people from the beginning to the end of the experience. All around the globe employees and organizations have been striving in a highly competitive world marketplace to empower their employees in order to convince them of the seriously improving customer service consistently and continuously (Sureshchandar and Anantharaman, 2001). Martinez-Costa and Jimenez (2009) specifically examine the important role of TQM with small businesses. As customers gain more confidence or experience with quality service, the customer weighs their prior assessment of service quality more heavily and places less weight on evaluating service excellence (Bolton, 1998). Without a solid explanation, an organization is prone to lose focus. Programs and businesses become caught up in the same 'ole routines of doing business by treating customers based on past practices (Tesch and Levy, 2008). Customer relationship management (CRM) technology provides a better understanding of customers and has become a popular strategic opportunity. Peltier, Schibrowsky, and Zhao (2009) findings showed that CRM adopters had higher product class knowledge, a greater risk orientation, saw a stronger relative advantage, perceived higher environmental complexity and hostility, and had a more open business change orientation. TQM and ISO 9000 is another major topic of research that has been widely examined (Bendell and Boulter, 2004; Chittenden, Poutziouris and Mukhtar, 1998; Sun and Cheng, 2002). Many people believe that not everything is perfect, but for many employees, they feel they are the ones who are doing what is right for the customer (Kotter, 2008). This has found to be true even in environments that are assumed not to be customer focused, such as in Russia prior to the fall of communism (Pooley and Welsh, 1994). The primary goal for total quality is to specify improvements and the goals expected from the organization in order to carry out financial gains and customer satisfaction expectations (Ward, Poling, and Clip, 2008). Management enhancement fads may come and go, but substantive, realistic programs can gather, continue, and lead to ultimate success in improving the quality of services in an organization (Barlow, 2008). An organization cannot take for granted that hiring kind-mannered, hard-working and sincere people is adequate (Wilcock, 1989).

## Big Five Personality Traits

Personality traits are a way to explain the differences that individuals present themselves to others (Korzaan and Boswell, 2008). Within customer service-oriented organizations, at least one of these personalities can be discovered within the organization of its employees. Researchers have narrowed these traits down to what is now known as the Big Five Personalities (Korzaan and Boswell, 2008).

*Agreeableness*

There are two personality characteristics to predict task performance and helping behavior of professionals working in teams. These characteristics are conscientiousness and agreeableness (Kamdar and Van Dyne, 2007). The identifying factors associated with agreeableness are good-natured, accommodating, trusting, and compassionate (Barrick and Mount, 1993). Based on this limited information, it is probable that a person with these personality characteristics would be well-suited to work in customer service. A person with these personality characteristics would be more likely to assist a customer by bagging purchased items, display a calm demeanor when confronted with a service demand, and involve others as a team player in resolving customer service problems. In general, persons with agreeable qualities have an over-whelming desire to help others in the time of need and assistance (Korzaan and Boswell, 2008).

*Conscientiousness*

Conscientiousness may be the single best personality predictor of work performance according to research on personality characteristics and employee selection. Those that have a conscientious personality characteristic have behaviors that predict positive job performance (Komar, Brown, and Robie, 2008). When an individual enters an organization, the new employee forms a relationship with the employer that consists of perceived mutual obligations (Orvis, Dudley, and Cortina, 2008). Scholars have long recognized that job performance depends heavily on how employees perceive their jobs (Grant, 2008). If an employee perceives their job as just a means to earn pay, then certain demeanor behaviors will begin to appear. This can include arriving late to work, verbal disagreements about the organization's plans, or even distancing themselves from other employees. Customer service can be adversely affected by this type of behavior. This in turn will have a negative affect on the organization and its reputation in the marketplace. However, in reference to the Big Five Personality Traits (Korzaan and Boswell, 2008), conscientiousness has the following characteristics: responsible, dependable, persistent, and achievement-oriented (Barrick & Mount, 1993). Conscientious individuals are sensitive of the risks involved whenever data is being collected for projects; therefore, these individuals are careful to give credit to sources that have been obtained in order to help the individual succeed in their projects (Korzaan and Boswell, 2008).

*Emotional Stability*

The normality-as-mental-health perspective defines normality mainly in the negative: normal people are those who are not mentally ill (Wood, Goslinga and Potter, 2007) but may lack confidence and experience anxiety (Barrick and Mount, 1993). For these types of employees, management must have patience in training the employee to be relaxed and not apprehensive to open up to customers. Yet, there are those types of employees that never recoup from their shyness, lack of confidence, or uneasiness. Some may eventually resign from the organization for lack of job fit.

*Extraversion*
The extraverted employee is sociable, talkative, and assertive (Barrick and Mount, 1993). An employee exhibiting this behavior strives to get the big sales, help improve the bottom line within the organization, and likes meeting customers. Psychologists would label this type of employee who works in customer service between agreeableness and extraversion because there are some parallel personalities involved. Extraverted employees are sensation seeking, sensitive to reward signals, achievement seeking, and are connected to happy, positive personality types (Furnham and Christoforou, 2007). Extraversion personality individuals enjoy being associated with large groups of people and enjoy being socially involved (Korzaan and Boswell, 2008).

*Openness to Experience*
Openness to experience is the last of the Big Five characteristics factors. With an openness to experience personality characteristic, the employee is inventive, artistically sensitive, and scholarly (Barrick and Mount, 1993). According to Barrick and Mount (1993), additional factors and traits include educated, inquisitive, unique, and broad-minded (Barrick and Mount, 1991). These individuals exercise substantial choice in the kinds of social environments they frequent based on their own individualities (Dollinger, Orf and Robinson, 1991).

The purpose of this study is to examine the predictive ability of the Big Five Personality Characteristics with two types of customer service-oriented performance – general customer service oriented performance and technical customer service oriented- performance across three samples of Chinese leaders from the entrepreneurial high technology, health care, and hospitality management industries.

## Methodology

*Sample*
The sample included 170 entrepreneurs involved in high technology ventures, 175 health care management executives, and 178 hospitality management executives. Their average age was 36.3 years. Three hundred two were male and 221 were female. No significant differences were found in age, sex, general customer service orientation, or technical customer service orientation between the three sub-samples.

*Measures*
The primary instrument utilized in the study was the Customer Service Selection instrument developed by McBride (1988; 1997; McBride, Mendoza and Carraher, 1997) as modified by Carraher and Associates (1998), with the modifications having been recommended by McBride et al. (1997). Results of the principal components analyses supported the five dimensional solutions for this sample. Due to problems with the use of coefficient alpha reliability estimates (Sethi and Carraher, 1993), limited information factor analysis as suggested by Schoenfeldt and Mendoza (1994) was employed before the calculating alphas. These ranged from .74 (openness to experience) to .86 (extraversion). Carraher and Associates (2002) found the six-month, test-retest reliability estimates to range from .73 (openness to experience) to .84 (extroversion).

In addition to demographic items, many of the questions contained in the inventory consisted of experiential, attitudinal, and behaviorally-based items (e.g. "When you were a member of a small group, how much do you participate? How comfortable are you in new places and situations?"). A five-point Likert scale was utilized.

Performance was measured by on-site performance observations. Three trained raters evaluated the performance of each respondent independently to insure inner-rater reliability. Each of the raters had graduate training in psychology and assessments and received additional training in order to accurately and consistently identify differing levels of service-oriented performance and technically-oriented performance in China. Both instruments have previously been used in China (Carraher, Franklin, Parnell and Sullivan, 2006).

## Results

The results of the relationship between the Big Five Personality Traits and general customer service and technical customer service performance are shown in Tables 1 and 2. There were significant differences between the three occupational groups (See Table 1). Forty-three point eight percent of the variance in general customer service oriented performance for the entrepreneurs was accounted for, while only 30.2% of the variance was accounted for health care management executives and 18.9% of the variance for the hospitality management executives. The specific traits that are significant also varied across occupations. For the technology entrepreneurs, extraversion, openness to experience, and conscientiousness were significant predictors of higher levels of general customer service. For the health care management executives, agreeableness, openness to experience, conscientiousness, and extraversion were the significant predictors of higher levels of general customer service. For the hospitality management executives, only agreeableness and extraversion were significant predictors.

Table 2 shows the results of the Big Five Personality Traits on technical customer service. The results are similar for technology entrepreneurs and hospitality management executives, but are slightly different for the health care executives. Openness to experience was not a significant predictor of a high level of technical customer service by health care managers. Forty-seven percent of the variance in technical customer service was accounted for the technology entrepreneurs, 32.4% for the health care management executives, and 26.0% for the hospitality management executives.

## Conclusion and Discussion

The results of the current study suggest that there may be occupational differences in customer service performance and technical customer service performance. Future research should examine other factors which might influence various facets of performance – and examine which facets of performance are most important in particular occupations (Carraher, Sullivan and Crocitto, 2008; Sturman and Carraher, 2007).

It is imperative to recognize that there are diverse personalities and levels of customer service performance. This research attempted to focus on a five identifiable personalities that are found in organizations. The Big Five Personality Traits (Korzaan and Boswell, 2008) can be used as an additional tool to aide in understanding individuals and their behaviors while performing customer service functions. Additional research beyond this preliminary study could sample diverse occupation and cultural backgrounds in order to see how generalizable performance measures and customer service measures may be (Carraher, Carraher and Whitely, 2003; Carraher and Welsh, 2009; Raven and Welsh, 2004; Sullivan, 1999). This would lead to better measures that would impact customer service performance and allow for training to better meet the needs of the workforce. For example, Welsh, Sommer, and Birch (1993) did just this comparing retail performance in two comparable bookstores in Russia with the use of employee reward systems. The study found that the effective use of employee reward systems, both financial and non-financial, had a significant impact on customer service and sales performance.

Behavior modification techniques could be examined to see if there was a positive impact on any of The Big Five Personality Traits (Korzaan and Boswell, 2008) on customer service performance. Welsh, Luthans, and Sommer (1993a, 1993b) used participative techniques to positively impact quality performance among Russian factory workers. Welsh, Bernstein, and Luthans (1992) applied positive reinforcement techniques to improve quality among U.S. fast food franchisee workers, including the level of service quality.

Future studies could also examine hope on service delivery and the quality of that delivery. DiPietro, Severt, Welsh, and Raven (2008) looked at leadership traits of franchisees versus managers and how these traits impact service quality delivery. The study also examined how hope affects service quality. Leadership traits could also be examined with The Big Five Personality Traits (Korzaan and Boswell, 2008). How hopeful managers are and how that affects service quality delivery of their employees could also be examined in light of employees' Big Five Personality Traits (Korzaan and Boswell, 2008). Hope of franchise leaders was compared in an exploratory study. Results showed that franchisors had about the same self-perceptions of hope about the future as franchisees (Welsh and Raven, 2010). This study could be replicated to include non-franchised retail locations and if hope has an impact on service quality.

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Table 1 – Regression Results of Big Five Personality Traits on General Customer Service **Entrepreneurs**

| Model | | Unstandardized Coefficients | | Stand. Coeff. | T | Sig. |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | 10.674 | .147 | | 72.399 | .001 |
| | Extraversion | .831 | .167 | .326 | 4.983 | .001 |
| | Conscientiousness | .569 | .166 | .242 | 3.437 | .001 |
| | Emotional Stability | -.062 | .137 | -.028 | -.451 | .653 |
| | Openness to Experience | .747 | .162 | .313 | 4.601 | .001 |
| | Agreeableness | .278 | .150 | .112 | 1.853 | .066 |

$R^2$= .438 Sig. = .0001

**Health Care Executives**

| Model | | Unstandardized Coefficients | | Stand. Coeff. | T | Sig. |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | 10.443 | .202 | | 51.621 | .001 |
| | Extraversion | .596 | .225 | .218 | 2.644 | .009 |
| | Conscientiousness | .810 | .279 | .250 | 2.903 | .004 |
| | Emotional Stability | -.485 | .264 | -.146 | -1.833 | .069 |
| | Openness to Experience | .794 | .209 | .268 | 3.797 | .001 |
| | Agreeableness | .876 | .188 | .332 | 4.651 | .001 |

$R^2$ = .302 Sig. = .0001

**Hospitality Management**

| Model | | Unstandardized Coefficients | | Stand. Coeff. | T | Sig. |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | 10.844 | .169 | | 64.113 | .001 |
| | Extraversion | .572 | .189 | .234 | 3.028 | .003 |
| | Conscientiousness | .151 | .185 | .064 | .817 | .415 |
| | Emotional Stability | -.340 | .179 | -.135 | -1.899 | .059 |
| | Openness to Experience | .265 | .171 | .112 | 1.553 | .122 |
| | Agreeableness | .781 | .184 | .301 | 4.242 | .001 |

$R^2$ = .189 Sig. = .0001

Table 2 – Multiple Regression Results of Big Five Personality on Technical Customer Service

**Entrepreneurs**

| Model | | Unstandardized Coefficients | | Stand. Coeff. | t | Sig. |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | 11.154 | .121 | | 92.292 | .001 |
| | Extraversion | .351 | .137 | .163 | 2.567 | .011 |
| | Conscientiousness | .821 | .136 | .414 | 6.043 | .001 |
| | Emotional Stability | .214 | .112 | .116 | 1.907 | .058 |
| | Openness to Experience | .514 | .133 | .255 | 3.860 | .001 |
| | Agreeableness | .121 | .123 | .057 | .981 | .328 |

$R^2$ = .470 Sig. = .0001

**Health Care Management Executives**

| Model | | Unstandardized Coefficients | | Stand. Coeff. | t | Sig. |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | 10.717 | .143 | | 74.915 | .001 |
| | Extraversion | .695 | .159 | .350 | 4.361 | .001 |
| | Conscientiousness | .797 | .197 | .338 | 4.039 | .001 |
| | Emotional Stability | .042 | .187 | .018 | .227 | .821 |
| | Openness to Experience | .030 | .148 | .014 | .202 | .840 |
| | Agreeableness | .491 | .133 | .255 | 3.688 | .001 |

$R^2$ = .324 Sig. = .0001

**Hospitality Management**

| Model | | Unstandardized Coefficients | | Stand. Coeff. | t | Sig. |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | 11.265 | .145 | | 77.682 | .001 |
| | Extraversion | .674 | .162 | .307 | 4.160 | .001 |
| | Conscientiousness | .280 | .158 | .132 | 1.767 | .079 |
| | Emotional Stability | -.266 | .154 | -.118 | -1.732 | .085 |
| | Openness to Experience | -.020 | .146 | -.009 | -.135 | .893 |
| | Agreeableness | .893 | .158 | .383 | 5.654 | .001 |

$R^2$ = .260 Sig. = .0001

# A LOOK AT MICROENTREPRENEURS AND THEIR ENTREPRISES: AN ASSESSMENT AND IMPLEMENTATION PLAN FOR SUCCESS

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## Abstract

Microenterprises have proliferated in many countries in recent years. Among its several associated merits are job creation and national economic upliftment. Drawing from the literature, the author identifies critical requirements for microenterprise survival and growth. Through an assessment of challenges and opportunities, a proposal for government program implementation is outlined. The study is useful to government officials, economic planners, international institutions, non-government organizations, policy makers, and consultants as they seek viable models for microenterprise expansion.

## Introduction to Microenterprises and Microentrepreneurs

The combined terms "micro" and "enterprise" suggest that microenterprises are fairly small business operations. Many of them have gross sales of under $25,000 a year (Tinker, 2000). Characteristics of microenterprises include owner-operated initiatives, marginalized population segment ownership, creative sales of product or service, varied entrepreneurial approaches, diverse organizational forms, and flexible locations and arrangements. Micro-enterprises are viewed as ventures that are owner-managed with few employees and limited capital (Tezler, 1992; Langer, Orwick, & Kays, 1999). Microentrepreneurs are usually challenged to find employment through regular channels, and tend to create their own jobs by starting a small business enterprise (Woodworth, 2000). This may be a full-time or part-time business arrangement.

In emerging nations, the marginalized sector is largely composed of women with families, the physically challenged, and residents in rural communities (Dorfling, 2001). However, in industrialized countries these businesses are often times started by immigrants that bring their skills with them but are often discriminated against in the workplace or do not have green cards. An example of this type of business would be the lawn care business. This can include creative means of sales of products and/or services such as street vendors, retailers, and traders that sell products or services to build income and expand assets (Eversole, 2004). Microenterprises utilize creative entrepreneurial approaches that are often characterized by chaos and driven by effective utilization of competencies in entrepreneurship, marketing, and innovation (Durkin & McGowan, 2001). Microenterprise success is measured by profitability (Chaganti & Chaganti, 1983). The driving force behind the start-up of most microenterprises is survival.

Microenterprises are organized in varying forms and may be structured as a sole proprietorship, partnership or family enterprise, typically with less than 10 employees, and more commonly under five employees (Storey, 1994; Walls et al., 2001). Microenterprises modes of operation vary widely and can change over the life of the business. The majority of micro-enterprises tend to be home-based operations (Clark et al., 1999). Piore and Sabel (1984) note that microenterprises have advantages in terms of flexibile business structures. These businesses traditionally have less barriers to entry and are able to function across diverse sectors of the

economy with lower capital and skill requirements (Lee, 2008). They have limited inventory and access to capital so they bootstrap operations (Eversole, 2004). Since they are small, microenterprises are much more able to be flexible and responsive to market and customer demands (*The Herman Trend Alert*, 2003).

Microenterprises are starting and growing throughout the world (Carbonara, 1997). A microenterprise is defined as a small, owner-operated enterprise usually started by a member of a marginalized segment of the population that sell a product, service, or combination thereof, through entrepreneurial efforts. These businesses take on various organizational forms and operate under flexible arrangements and in multiple locations to contend with entry barriers and capital constraints. They respond to market trends and customer requirements to achieve profitability and business growth. In a study on developing nations, Larson and Shaw (2001) further characterize micro- and small enterprises (MSE) as: 1) mostly family-owned, with family members working in the business, 2) driven by one person, 3) largely situated in rural areas, 4) involved in trading and manufacturing, 5) characterized by multiple start-up and failure rates, 6) founded primarily by women, and 7) operated on a small basis with low income earnings.

Microenterprises have positively impacted several facets of society by opening opportunities. Specifically, they have had a major economic impact in developing nations (De Soto, 1989). Microenterprises have helped economies progress despite limited support from government and business organizations (*The Futurist*, 2003). These businesses have also been a pathway to job creation by providing opportunities to those who would not be able to find jobs conventionally or in third-world economies thereby increasing survival (Rogerson, 2004). For example, in the Dominican Republic microenterprises contribute a significant portion of total family income (Espinal & Grasmuck, 1997). Microenterprises alleviate poverty by generating income (Servon, 1999).This is especially true for women around the world (Todd, 1996). Microenterprises are the vehicle to gain financial independence through self-employment for women while contributing to the support of their children and family (Clark et al., 1999). Microenterprises also provide more affordable goods and services to the community because they are usually lower in price (Kirkpatrick & Hume, 2001).

While there are several advantages of microenterprises, there are also challenges which include negativism, lack of support, lack of access to credit, beaucratic barriers, market access and geographic constraints, lack of infrastructure, growth and expansion challenges, lack of market understanding, poor industry acumen, and lack of management skills. Microenterprises may be viewed negatively in the context of image-small is not positive (Orser & James, 1992). In some societies, business incentives are provided for large corporations. Microenterprises are not provided attention nor support (*The Herman Trend Alert*, 2003). There are many bureaucratic hurdles that microenterprises encounter. Some cities even prohibit small ventures to be operated from homes (*The Herman Trend Alert*, 2003). This was the case in Cleveland, Ohio, before the ordinance was reversed in 2004. It was brought to the attention of the City Council by a group of Students in Free Enterprise members at John Carroll University. The result was an emergency resolution by one of the Council Members that was an alumni of the university. Art Summit I and II was born out of this attention which later resulted in the Council of Small Enterprises (COSE) funding a major business plan competition for the arts and a focus on the quality of life issues around the arts.

Oftentimes, there is lack of access to credit. In some cities, microenterprises have to deal with commercial bank practices that have unfair biases towards small firms (*The Herman Trend Alert*, 2003). Many formal lenders shy away from micro-enterprise markets. The result is microentrepreneurs have difficulties in accessing capital (Pollinger, Outhwaite, & Cordero-Guzman, 2007). There is also market accessibility issues and geographic constraints. Microenterprises are often times situated in rural locations and they are faced with challenges relating to market size and distance to market, labor, and suitable infrastructure (Dabson, 2002). Microenterprises tend to lack integration into mainstream production systems (Qualmann, 2000). This leads to growth and expansion challenges. Microenterprises tend to have difficulty growing beyond a one-person structure (Berry et al., 2002). Microenterprises that are in sectors having poor growth tend to subsequently have poor performance (Berry et. al, 2002). Aside from training, microentrepreneurs need other business service support such as technology access, marketing support, and research assistance (Goldmark, 2001). Please see Table 1 for the challenges and opportunities of microenterprise characteristics.

## Microenterprise Programs (MEP's)

Programs for microenterprises have been growing. These programs have increased loan access and support services to economically challenged sectors of the society (Kibria et al., 2003). In the United States, there are over 650 micro-enterprise development programs (Severens & Kays, 2002). These programs are directed toward poverty and job creation, economic growth, women-owned businesses, training, private sector linkages, marginalized sectors, entrepreneurially focused businesses, and businesses in need of long-term strategies.

Microenterprise programs play a role in poverty alleviation and job creation (Servon, 1997). Some programs cultivate microenterprises to address worker displacement, community poverty, and even assistance to those with disabilities (Sonfield & Barbato, 1999; Himes & Servon, 1998; Walls et al., 2001). Microenterprise programs contribute to economic growth and development (Monroe, Allen, & Price, 1995) and are largely directed towards women (Servon, 1996). In the US, microenterprise programs tend to emphasize training and technology support as opposed to loans (The Aspen Institute, 1999). Microenterprise can be linked with programs in the private sector (USAID, 1994). Success of microenterprise programs should be anchored on their ability to merge marginalized sectors into the economic mainstream (Woolcock, 2001). Some microenterprise developments programs do not necessarily reach out to the poorest in the society, and at times reach more educated parties (Bates & Servon, 1996; Dumas, 1999). Business development initiatives should be directed towards profitability and productivity enhancements (Miehlbradt, 2002). In micro-enterprise development programs in the US, successful start-up has been attributed to previous work experience as well as a keen understanding of business goals (Edgcomb, 2002). There is value in the introduction of effective strategies that addresses economies of scale and sustainability (Miehlbradt & McVay, 2004).

## Microenterprise Training

Microenterprise programs are typically associated with training initiatives. The characteristics associated with microenterprise training include improved self-sufficiency and financial gains, heightened morale, improved operations management skills, innovation and training skills, increased networking opportunities, increased technology and information support, and improved mentoring with a strong community focus.

Participation in training exercises improves the chances for microentrepreneurs to engage in self-employment (Benus et al., 1995). Microenterprise training can lead to increased assets (Putnam, 1993), heightened morale, and a positive attitude (Putnam, 1993). With limited access to credit training, gaining knowledge on how to operate a business is critical (Servon & Doshna, 2000). In a study on Community Entrepreneurs Programs, Dumas (2001) observed the need for greater analysis of business plans (West, 2009). Cook, Belliveau, and Von Seggern (2001) suggest that feedback opportunities, learning incentives, generous completion time deadlines, and information on access to funding enhances microenterprise training. Networking can strengthen the microenterprise operational base (Dumas, 2001). Aside from training, microentrepreneurs need other business support services, such as technology access and research assistance (Goldmark, 2001). Added support through mentors can be particularly helpful to microenterprises (Dumas, 2001). Entrepreneurial development training should be community focused, aimed at the microenterprise's operation with a strong emphasis on the entrepreneur, provide opportunity for long-term learning, and embrace all segments of society (Levere, 2005).

## Microfinance-Microenterprise Interface

Closely associated with a microenterprise's success is their ability to access credit. Microfinancing is characterized by small loans in the $70-100 range that are directed towards marginalized sectors of society, typically in developing countries (Woodworth, 2000). Characteristics include a wide variety of forms, low income levels, a lack of collateral, negative perceptions from traditional banks, banking cost inefficiencies, lack of financial knowledge, and group-based lending. These efforts contribute to a positive entrepreneurial spirit, stronger family and community institutions, more effective learning and networking among microenterprises, more effective resource utilization, lower loan default rates, and more effective financial management.

Banking institutions in countries like France, Germany, and Italy tend to play a larger role in supporting small businesses as compared to banks in other countries (*The Futurist*, 2003). The microenterprises' low income poses challenges to asset build-up and financial credibility, thereby limiting credit access (Adams, Graham, & Von Pischke, 1984). Microentrepreneurs would not have access to conventional banking due to lack of creditworthiness and unavailability of collateral (AEO, 2005). Traditional banks hesitate to lend to the poor due to negative credit risk perceptions and transaction cost inefficiencies (Mayoux, 1995; Berger, 1989). In a survey of micro-enterprises in Malaysia, 84% of the 500 respondents claimed they require knowledge on basic financial management to get a loan (Huifen, 2009). Group-based micro-finance was introduced in the 1970's and addresses the needs of the poor (Desai, 1982; Hulme & Mosley, 1996). Group microfinance can lead to developmental opportunities for the poor in terms of personal and social empowerment (Otero, 1989). Woolcock (2001) pointed out that group lending tends to spread out the risks and builds on social relationships for enhanced loan performance. Group based microfinancing can contribute to political development (Bhatt, 1997). Goldmark (2001) referred to two models of capital access for microentrepreneurs in Latin America as: 1) solidarity group lending – where a single loan is offered to three to five entrepreneurs with joint accountability for the team, and 2) village banking – where entrepreneurs are grouped by 30, and funds are released and paid for in six to eight month cycles with members paying dues interest monthly and the principal amount at the end of each cycle. Kibria et al. (2003) alludes to a financial model called peer-lending groups, where a team of entrepreneurs collaboratively facilitate loan provision and repayment.

Microfinancing enhances self-esteem (Wahid, 1994). Through microcredit opportunities, there has been observed trends towards reduction of violence against women engaged in business (Hashemi et al., 1996). Woller and Parsons (2002) cited two ways where microfinance can impact the community. One is directly through purchase increases, and the second is through expansion of consumption across diverse sectors. Kibria et al. (2003) point out that peer lending groups provide an opportunity to learn, gain credibility, strengthen networks, and build camaraderie. It allows communities to better utilize their resources and take ownership in their decisions (Holt, 1994). In Bangladesh, Grameen Bank instituted a system where the bank provides a training program for a group of five, then provides a loan to one or two members, with potential loan extension to the rest based on successful repayment (Gibbons, 1994). Under this system, the loan default rate is about 2% (Kibria et al., 2003).

Bhatt and Tang (2001) identify successful group micro-finance approaches to include tailor fit financial delivery after careful assessment of needs, a need for careful consideration of structure or group-based forms, consider the loan objectives and the market being served, careful group selection with attention to cohesiveness, market-based rates and system needs to be short-term, mechanisms for the encouragement of savings, provisions for training and technical assistance, and encouraging linkages and partnerships.

## Microenterprise Internationalization

In a survey of 500 micro-enterprises in Malaysia, 40% claimed they wanted to expand overseas (Huifen, 2009). Some firms, particularly in the high-tech sector have been described as born-global (Knight & Kavusgil, 1996). There have been opportunities for young entrepreneurial firms to internationalize early (Jolly et al., 1992). Through the development of inherent competencies and pursuit of specialized markets, small firms have the ability to internationalize even with resource limitations (Oviatt & McDougall, 1993). There is an opportunity for government entities to support micro-enterprise internationalization.

## Microenterprise Policy

Numerous government policies have been implemented to support microenterprises. Government programs have evolved towards heightened emphasis on market competitiveness, privatization, and reduction of government intervention (Tweeten & McClelland, 1997). Characteristics of microenterprise policies include opportunities for economic development, market expansion, and self-sufficiency (See Table 2). There is an opportunity to focus on the smaller sectors and increase the ability of the poor to participate in the economic mainstream. This can be achieved through economic linkages.

Promoting the expansion of microenterprises can lead to job creation, financial betterment, and self-sufficiency in communities (Johnson, 1998). Market expansions will subsequently result in an elevation in standards of living and to less reliance on government support (World Bank, 1995; Novogratz, 1992). While government organizations tend to devote attention to associate economic progress with large firms, there is an opportunity to focus on smaller firms (*The Futurist*, 2003). This would result as Woolcock (2001) proposes the convergence of the poor into the economic mainstream. In the case of Britain, without access to capital, small businesses cannot contribute toward economic growth and global competitiveness (*The Futurist*, 2003).

Microenterprise support can come through creative alliances and inter-organizational linkages (Goldmark, 2001). Woolcock (2001) proposes the following linkages that work for microenterprise development: cultivation of active communities, convergence of the poor into the economic mainstream, reliable and efficient institutions, and healthy alliances and inter-organizational partnerships. There is need for market understanding and evaluation, precise market focus, identification of the appropriate support structure, preparation for commercialization, and use of inter-organizational alliances (Rogerson, 2006). Woolcock (2001) cited the need for more reliable and efficient institutions. Microenterprise sustainability becomes viable through continuous support and clear procedures for development (Panjaitan-Drioadisuryo & Cloud, 2009). With active community involvement, this can lead to sustainable microenterprise growth.

Overall, there are some major issues that will need attention. For a complete list of challenges proposed government agenda please see Table 3. One is an emphasis towards broader structural issues since most micro-enterprises are detached from mainstream production networks (Qualmann, 2000). Poverty alleviation programs need to embrace disengaged groups, as well as extend credit and technological support through well-designed microenterprise programs (Tinker, 2000). In developing societies, issues such as political risk, country debt, corruption, and fiscal mismanagement among others hamper efforts toward economic stimulus and intervention (Aworuwa, 2004). Lack of an institutional framework that supports optimal resource utilization can impede economic progress (Shaffer, 1989). When developing programs for microentrepreneurs, consideration of factors such as capital accessibility, policies and procedures, learning environment, and information gathering and assessment should be first considered (Levere, 2005). There needs to be openness towards change and improvement (Levere, 2005). Key policies should include larger loan access, broadening the market base, growth sector market training, and proper evaluation and assessment (Servon & Bates, 1998).

## Conclusion

The gathered literature and analysis point out to the fact that: 1) contemporary microenterprises are confronted with numerous challenges as well as opportunities, 2) governments and policy makers need to consider a broad range of factors when trying to identify viable models for microenterprise development, 3) in the effort towards microenterprise development in countries, it would be helpful to explore and assess potential policies in the context of the firm, institutional, and national level, 4) with the numerous courses of action, across different levels, it would be helpful for government entities to prioritize implementation and strive for consistency of implementation, 5) having a unified theme and integrated system that connects the planned activities and meets established goals, would heighten the prospects for success for a national microenterprise program.

## Concluding statements

This study has been derived from academic and business literature on microenterprises. Quantitative studies on the subject would be of high value to policy makers, government officials, and consultants.

Microenterprises will continue to grow and define the future of many countries. Economic growth in years to come will be shaped by microenterprises (*The Futurist*, 2003). The success of

microenterprise activity lies largely on governance and the role institutional forces play. Future microenterprise development requires both financial and non-financial support to develop their businesses and expand into new markets (Goldmark, 2001).

Microenterprises can positively impact economies. In societies with high unemployment, workers who lose their jobs tend to become self-employed and eventually positively impact the economy (*The Herman Trend Alert*, 2003). In "AEO Calls for Full Funding of PRIME" Business Wire press release, Association for Enterprise Opportunity (AEO) President Connie Evans pointed out that microenterprise growth is a pathway towards economic recovery due to associated business expansion and job creation (2009).

Microenterprise activities provide marginalized sectors and budding entrepreneurs hope for the future (Panjaitan-Drioadisuryo & Cloud, 1999). For millions of the struggling poor, the ability to engage in micro-entrepreneurial pursuits is a gateway to prosperity and governments hold the key.

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Table 1. Microenterprise Characteristics: Challenges and Opportunities

| Characteristics | Opportunities | Challenges |
|---|---|---|
| Definition | | |
| Owner-operated initiatives | X | |
| Participated by marginalized segments | X | |
| Utilize sales of product or service | X | |
| Driven by entrepreneurial approaches | X | |
| Diverse organizational forms | X | |
| Flexible locations and arrangements | X | |
| Low entry barrier | X | |
| Constrained by capital | | X |
| Responsive to market trends and customer requirements | X | |
| Experiencing growth | X | |
| Opportunities | | |
| Contributes to economic growth | X | |
| Pathway to job creation | X | |
| Increases family income | X | |
| Alleviates poverty | X | |
| Improves the welfare of women | X | |
| Lowers prices of goods | X | |
| Challenges | | |
| Negative association | | X |
| Lack of support | | X |
| Bureaucratic hurdles | | X |
| Lack of credit access | | X |
| Market access and geographic constraints | | X |
| Resource constraints | | X |
| Lack of infrastructure | | X |
| Growth and expansion challenges | | X |
| Poor industry understanding | | X |
| Lack of management skills | | X |
| Microenterprise programs | | |
| Directed towards poverty and job creation issues | X | |
| Contributor to economic growth | X | |
| Directed towards women | X | |
| Emphasize training | X | |
| Potential for linkages with private sector | X | |
| Need to focus on more marginalized sectors | | X |
| Entrepreneurial focus needed | | X |
| Need for long-term strategic direction | | X |
| Microenterprise training | | |
| Contributes to self-sufficiency and financial gains | X | |
| Heightens morale and business disposition | X | |
| Need emphasis on business operation skills | X | |
| Require innovative and responsive teaching approaches | | X |
| Strengthened by networking opportunities | X | |
| Require technological and informational support | | X |
| Need close mentoring | | X |

| | | |
|---|---|---|
| Need for strong community orientation | | X |
| Microfinance | | |
| Implemented in diversity of forms | X | |
| Constrained by low microenterprise income | | X |
| Constrained by lack of collateral | | X |
| Negative perceptions from traditional banks | | X |
| Banking cost inefficiencies | | X |
| Constrained by lack of financial knowledge | | X |
| Success seen in group based lending initiatives | X | |
| Contributes to positive entrepreneurial disposition | X | |
| Contributes to stronger family institutions and community development | X | |
| Contributes to learning and network expansion | X | |
| Enhances more efficient resource utilization | X | |
| Good models have low loan default rates | X | |
| Need for efficient financial management | | X |
| Internationalization | | |
| Opportunity for internationalization | X | |
| Microenterprise Policy | | |
| Opportunity for economic development | X | |
| Opportunity for market expansion | X | |
| Pathway towards self-sufficiency of citizens | X | |
| Focused on larger sectors | | X |
| Need for better integration | | X |
| Poor support for microenterprise credit access | | X |
| Opportunity for creative linkaging | | X |
| Need for institutional efficiencies | | X |
| Need to provide continuous support | | X |
| Need for community involvement | | X |
| Need for clarity of vision | | X |
| Need for entrepreneurial emphasis | | X |
| Need for holistic perspective | | X |
| Need for effective programs | | X |
| Affected by country perceptions | | X |
| Lack of institutional framework | | X |
| Need for efficient information gathering | | X |
| Need for efficient infrastructure | | X |
| Need for flexibility and innovative spirit | | X |
| Need for assessment mechanisms | | X |

Table 2. Microenterprise Opportunities and Proposed Government Agenda

| Microenterprise Opportunities | Proposed Government Agenda |
|---|---|
| **Firm Level** | |
| Owner-operated initiatives | Encourage personal ownership through incentives and tax breaks |
| Participated by marginalized segments | Communicate message pertaining to microenterprise opportunities to the grassroot levels |
| Utilize sales of product or service | Identify and promote expansion of products and services in growth industries and those that offer national competitive advantage |
| Driven by entrepreneurial approaches | Promote entrepreneurial training in the grassroot level |
| Diverse organizational forms | Be flexible to different organizational design and structures |
| Flexible locations and arrangements | Introduce policies that embrace innovation |
| Low entry barrier | Encourage broad participation |
| Responsive to market trends and customer requirements | Facilitate widespread and consistent information dissemination of business trends and opportunities |
| Experiencing growth | Facilitate growth and expansion of high-potential sectors |
| Contributes to economic growth | Monitor and evaluate impact of microenterprises in the economy |
| Pathway to job creation | Provide incentives to stimulate microenterprise growth and expansion specially in areas where unemployment is high |
| Increases family income, alleviates poverty, and improves the welfare of women | Direct program support to marginalized segments of society |
| Lowers prices of goods | Study and assess industries that could benefit from lower price and tie-in with microenterprise development programs |
| **Institutional Level** | |
| Microenterprise programs | |
| Directed towards poverty and job creation issues, Contributor to economic growth | Support pro-microenterprise institutional initiatives |
| Directed towards women | Support pro-women institutional initiatives |
| Emphasize training | Support microenterprise training initiatives |
| Potential for linkages with private sector | Explore and facilitate cross-sector engagement and collaboration |
| Microenterprise training | |
| Contributes to self-sufficiency and financial gains, heightens morale and business disposition | Support microenterprise training initiatives |
| Need emphasis on business operation skills | Explore and facilitate cross-sector engagement and collaboration |
| Strengthened by networking opportunities | Support and strengthen opportunities for inter-organizational alliances |
| Microfinance | |
| Implemented in diversity of forms | Be flexible to different organizational design and structures |

| | |
|---|---|
| Success seen in group based lending initiatives | Explore and facilitate group-based lending initiatives |
| Contributes to positive entrepreneurial disposition, contributes to stronger family institutions and community development, contributes to learning and network expansion | Support microenterprise training initiatives, specially those directed towards entrepreneurial enhancement |
| Enhances more efficient resource utilization | Study and explore modalities for optimal microenterprise resource utilization |
| Good models have low loan default rates | Identify and implement best loan practices that supports micro-enterprise growth |
| **National Government level** | |
| Internationalization | |
| Opportunity for internationalization | Develop and promote policies that facilitates microenterprise internationalization |
| Microenterprise Policy | |
| Opportunity for economic development, opportunity for market expansion, pathway towards self-sufficiency of citizens | Evaluate, develop and implement policies directed at economic development through microenterprise growth |

Table 3. Microenterprise Challenges and Proposed Government Agenda

| Microenterprise Challenges | Proposed Government Agenda |
|---|---|
| **Firm Level** | |
| Constrained by capital, lack of credit access | Facilitate small-scale capital access specially to those in marginalized segments |
| Negative association | Promote positive image for microenterprises |
| Lack of support | Facilitate direct and indirect support to facilitate microenterprise growth and expansion |
| Bureaucratic hurdles | Streamline procedures for access to microenterprise information, training, and procurement of business permits among others. |
| Market access and geographic constraints, resource constraints | Identify micro-enterprise clusters where specialized skills may be jointly cultivated alongside available resources |
| Lack of infrastructure | Identify priority areas that require infrastructure and public-private cooperation and interfaces |
| Growth and expansion challenges | Select and prioritize high-impact growth sectors for developmental focus |
| Poor industry understanding | Facilitate information dissemination of opportunities up to the grassroot levels |
| Lack of management skills | Implement programs directed at business skills development |
| **Institutional Level** | |
| Microenterprise programs | |
| Need to focus on more marginalized sectors | Develop and support programs directed at marginalized sectors |
| Entrepreneurial focus needed | Support training programs and initiatives that cultivate entrepreneurship |
| Need for long-term strategic direction | Consider aspects pertaining to long-term growth and |

| | |
|---|---|
| | program sustainability |
| Microenterprise training | |
| Require innovative and responsive teaching approaches | Support continuous program innovation |
| Require technological and informational support | Provide technological and information support |
| Need close mentoring | Facilitate institutional collaboration where public-private linkages are developed |
| Need for strong community orientation | Facilitate collaboration of institutions, private sector, as well as local government units in community development |
| Microfinance | |
| Constrained by low microenterprise income, lack of collateral | Introduce and support creative means where capital may be made available to the grassroot level |
| Negative perceptions from traditional banks, banking cost inefficiencies | Partner with banks or provide specialized incentives to gain microenterprise support |
| Constrained by lack of financial knowledge, need for efficient financial management | Facilitate the provision of financial training for microenterprises through the utilization of private, public, and institutional partnerships |
| **National Government Level** | |
| Microenterprise Policy | |
| Focused on larger sectors, need for better integration | Implement policies that support microenterprises |
| Poor support for microenterprise credit access | Facilitate broad-based credit access through strategic partnerships |
| Opportunity for creative linkaging, need for flexibility and innovative spirit | Explore resource optimization through collaboration and alliances, and pursuit of innovation |
| Need for institutional efficiencies, need for effective programs | Develop and implement policies and procedures that build on the efficiency of microenterprise activities |
| Need to provide continuous support, need for assessment mechanisms | Conduct program evaluation and assessments to determine areas where support may be inadequate |
| Need for community involvement, lack of institutional framework, need for efficient information gathering | Partner with public, private, and institutional organizations in furthering the microenterprise development agenda |
| Need for clarity of vision, need for holistic perspective | Develop a unifying theme or a national campaign that will define the microenterprise platform and set the framework for an integrated strategy |
| Need for entrepreneurial emphasis | Nurture and cultivate the entrepreneurial spirit in national campaigns and policies |
| Affected by country perceptions | Implement measures to present a positive national image to the global community |
| Need for efficient infrastructure | Identify priority areas that require infrastructure and public-private cooperation and interfaces |

# THE STATE OF ENTREPRENEURSHIP IN EASTERN EUROPE OVERCOMING THE CHALLENGES OF INTERNATIONAL ANALYSIS

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## Abstract

This installment of entrepreneurship and risk-taking capitalism in Eastern Europe updates the macro-political, economic, and societal conditions in the seven countries we are studying – Belarus, Poland, Romania, Russia, Serbia, Slovenia, & Ukraine – following the onset of the global economic crisis. This preliminary step of assessing market sustainability is in preparation for conducting an entrepreneurial enterprises survey in those countries. The aim of the survey is to assess whether or not Eastern European countries are moving in different directions, in terms of their international relations and market economies. This research is part of a global entrepreneurship research project that aims to contribute to the discussion of what is the optimal environment for risk-taking entrepreneurship and market capitalism. Successfully conducting the survey is the next step.

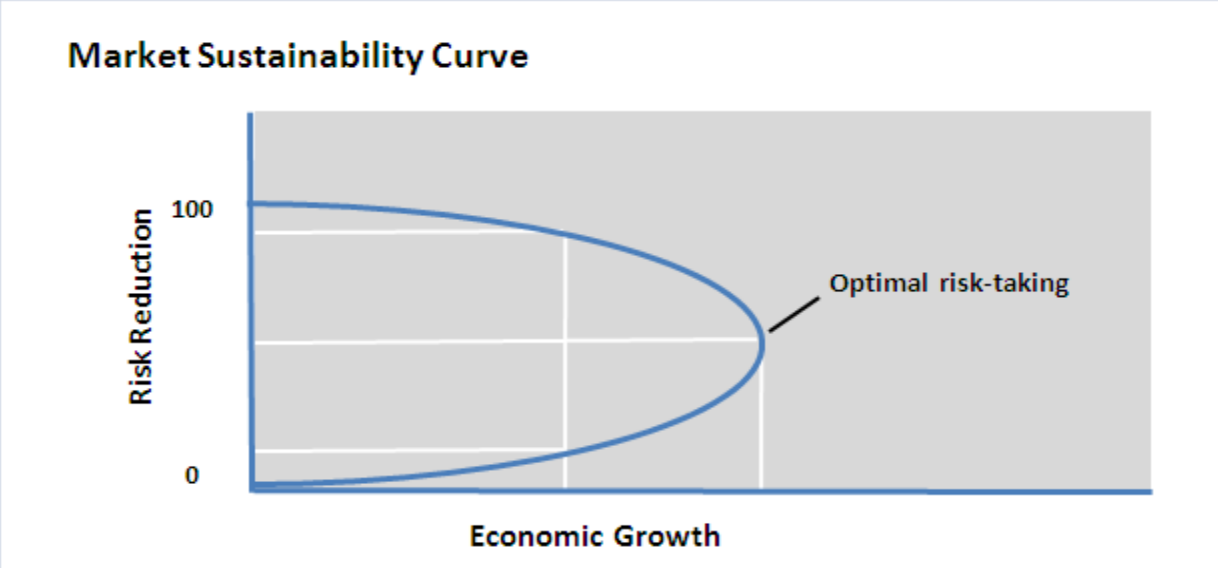
## Introduction

The purpose of this paper is to continue the Eastern European Entrepreneurship (EEE7) project by updating the risk analysis to take into account the global economic crisis, the knock-on effects of which are expected to have a dramatic effect on their respective domestic economies. Fiscal, enterprise credit, and bank liquidity pressures remain acute. Market capitalization of listed companies declined dramatically between 2007 and 2008. But business registration and other ease of doing business indicators have also eased dramatically. With this information in hand we can then address the question, are they in favor of firm formation and private sector development?

Ever-broadening market access – entrepreneurship and risk-taking capitalism – sustains globalization and market capitalism. Entrepreneurship, firm creation, and private sector development foster competition and increase economic growth (Klapper, et al., 2007). Entrepreneurs also shape nations. Entrepreneurial capitalism is representative of decentralized and diffused economic and even political power. It is also characteristic of an egalitarian society.

Firm creation depends on the state's provision of optimal market conditions, in particular, a stable legal and regulatory environment and capital markets, and efficient business registration procedures (Klapper, et al., 2007). The Market Sustainability Curve (shown in Figure 1) indicates an optimal level of a government ensured reduced risk environment for risk-taking, economic growth, and market sustainability. Any higher level of reduced risk inhibits economic growth that compromises market sustainability. Any lower level of reduced risk increases market volatility that increases economic uncertainty and compromises market sustainability.

Figure 1: The Market Sustainability Curve




**Source:** Variation of Weiss, 2009

The long-term trend has been an increasing state presence in the market. The post crisis market environment has greatly accelerated this trend. It is critically important now, given the changed set of circumstances, to assess what level of reduced risk is necessary for optimal risk-taking, economic growth, and market sustainability.

The triangle of social space depicted in Figure 2 illustrates the market integration process as the interaction of state, firm, and civil (i.e., entrepreneurial) society at the global, regional, and local levels (Weiss, Unpublished Manuscript). Of particular interest to entrepreneurship research are the three vertical two-directional arrows that traverse all levels. This indicates that "all politics (and economics) is local." If these 'avenues of participation' are open, we avoid pareto optimal redistribution of existing wealth through market access and the creation of new wealth.

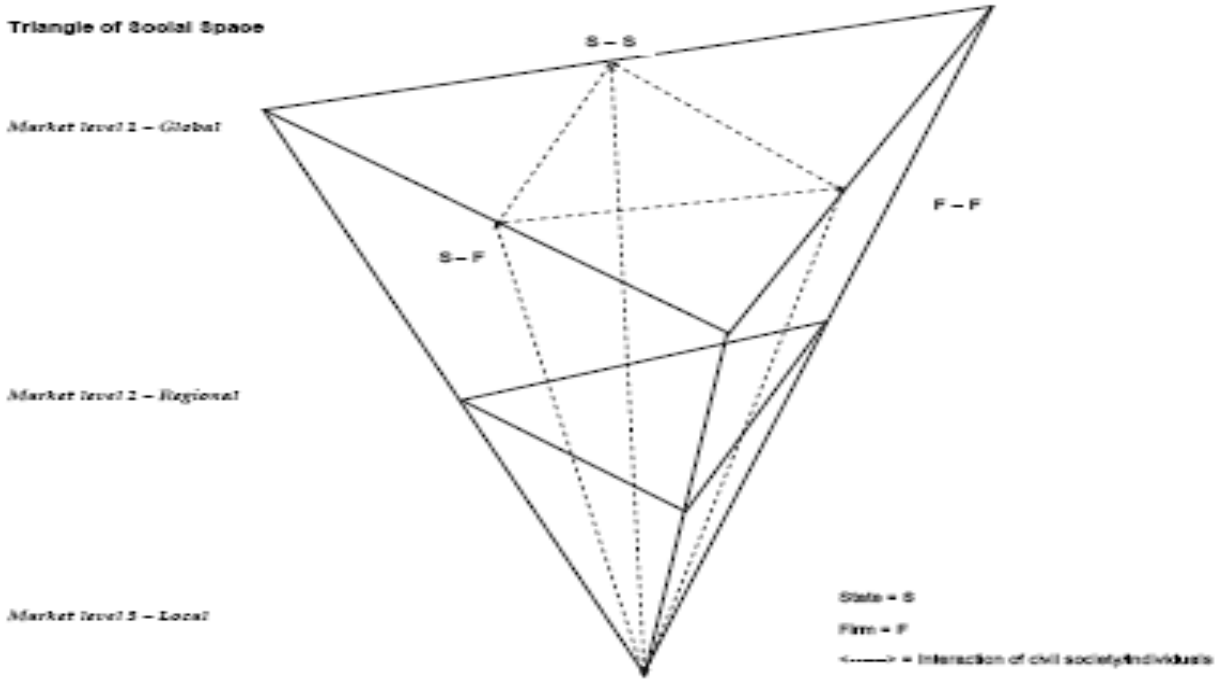
The 'avenues of participation' in the 'triangle of social space' are the:

I. S–S avenue – international relations and state presence in the market as an actor (SOEs, expropriation, nationalization)

II. S–F avenue – the regulatory environment for firms, public-private partnerships, transnationality (i.e., host state interest in FDI)

III. F–F avenue – level of market competition

Figure 2: Triangle of Social Space




Political risk analysis at the global level indicates the level of state presence in the market has increased, which may compromise the openness of the S–S avenue of participation at the global level. It is now necessary to assess political risk at other market levels. Assessing the regulatory environment – the openness of the S–F avenue of participation – requires business risk analysis. Economic risk analysis assesses the level of market competition and the openness of the F–F avenue of participation. The risk analysis also includes societal risk analysis at the local level.

## Risk Analysis – Regional and Local Levels

The map of Eastern Europe (see Figure 3) shows the seven Eastern European countries in this research. They are located from north to south from Russia in northeastern Europe and Serbia in southeastern Europe with Poland and Slovenia to the west. We will now 'map' the risks and freedoms – political, economic, business, and societal – of these countries in order to get a bird's eye view from which to begin survey analysis. Moreover, because the economic structures, relative size, income per capita of the EEE7, etc. are extremely variable, we can analyze the different market conditions and their affect on entrepreneurship across the region.

The political, economic, business and societal risk analysis shows comparative market conditions in the region. The risk variables are quantified and color-coded spectrum from red (positive) to purple (negative) to rank intra-EEE7 risk levels.

Figure 3: Map of Eastern Europe

*Political Risk*

The political risk variables listed below indicate mid-2009 political conditions. Business Monitor International (BMI) assesses the short- and long-term political risks in Eastern Europe higher (over 58) than the regional average (around 70) and that of other emerging markets (64 in the short-term, 59 in the long-term). Slovenia has lowest political risk in the short- and long-term. Poland follows but it long-term assessment is less positive than Slovenia's, which improves significantly. Russia's short-term political risk is third lowest among EEE7 but the long-term prognosis is less positive. Romania's political risk is high in the short-term but expected to greatly improve in the long-term. The same is true for Ukraine, albeit at much higher levels of political risk. Belarus, while forecast to have comparatively low political risk in the short-run, conditions are expected to deteriorate dramatically in the long-run. Serbia presents consistently high political risk.

The global economic crisis has further differentiated the Moody's sovereign credit ratings of EE7 countries. The most creditworthy countries continue to be Slovenia followed by Poland. Russia's long-term sovereign credit rating remains Baa1 but the outlook was downgraded from positive to stable in July 2009. Next comes Romania with a Baa3, stable rating, which is unchanged since the last risk analysis in Fall 2008. Moody's downgraded Ukraine's long-term sovereign credit rating to B2, negative outlook in May, 2009. Political instability among the country's two most powerful political leaders threatens macroeconomic stability and a further downgrade of the Ukraine's sovereign credit rating. Belarus has the next lowest credit rating of B1 but its outlook remains stable.

The political risk table (See Table 1) indicates the level of reserve assets declined in three of the four countries, Russia, Slovenia, and Ukraine, with Russian and Slovenian reserves declining by 16 percent and 12 percent, respectively. The central banks of the other four countries, Poland,

Serbia, Belarus, and Romania, increased their reserve balances by as much as 28 percent. The level of reserves and changes to it measure the extent to which the country's government is "self-insuring" itself from international balance of payment difficulties. Foreign currency and other reserves balances are also indicative of funds not being used in the domestic economy. In other words, if the central bank has built up reserves to protect itself from international financial obligation shortages, or, to invest overseas, these monies are unavailable for domestic use. This may increase domestic political, societal, and economic risks.

Table 1: Political Risk Table

| Political Risk Variables | | Belarus | Rank, Year | Poland | Rank, Year | Romania | Rank, Year | Russia | Rank, Year | Serbia | Rank, Year | Slovenia | Rank, Year | Ukraine | Rank, Year |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Political Risk (Q4 2009) | Short-term | 62.5 | 34 | 73.8 | 20 | 58.3 | 40 | 59.6 | 68 | 44.6 | 46 | 74.4 | 19 | 38.3 | 48 |
| | Long-term | 32.4 | 50 | 75.4 | 26 | 71.6 | 29 | 48.9 | 44 | 47.5 | 46 | 83.3 | 14 | 49.5 | 43 |
| Sovereign credit rating (Moody's, September 23, 2009) | Foreign currency | B1 | Stable | A2 | Stable | Baa3 | Stable | Baa1 | Stable | na | | Aa2 | Stable | B2 | Negative |
| | Local currency | B1 | Stable | A2 | Stable | Baa3 | Stable | Baa1 | Stable | na | | Aa2 | Stable | B2 | Negative |
| Official reserve assets (percent change, year-to-date) | | 0.13 | Aug-09 | 0.28 | Aug-09 | 0.08 | Aug-09 | -0.16 | Jul-09 | 0.18 | | -0.12 | Jul-09 | -0.06 | Jul-09 |
| External debt stock/GDP (Current US$, percent) | | 0.21 | 2007 | 0.46 | 2007 | 0.51 | 2007 | 0.29 | 2007 | 0.66 | 2007 | na | 2007 | 0.52 | 2007 |
| Political Freedom (193 countries; Political Rights, Civil Liberties) | | Not free | 7, 6 | Free | 1, 1 | Free | 2, 2 | Not free | 6, 5 | Free | 3, 2 | Free 1,1 | 1, 1 | Free | 3, 2 |
| Failed States Index, 2009 (148 countries, 120 maximum FSI score) | | 82.3, in danger | 66 | 49.6, stable | 142 | 61.3, borderline | 129 | 80.8, in danger | 71 | 78, in danger | 79.2 | 36.3, stable | 156 | 69.7, borderline | 110 |
| Global Corruption Barometer, 2009 (69 countries; 1: Not at all corrupt to 5: Completely corrupt) | | 3.4 | | 3.5 | | 4.0 | | 3.9 | | 3.9 | | na | | 4.3 | |
| Press Freedom, 2009 (195 countries) | | 91, not free | 188 | 24, free | 49 | 44, partly free | 94 | 80, not free | 174 | 39, partly free | 83 | 24, free | 49 | 55, partly free | 115 |
| Group Rank: Relative Risk, Size, etc. | Lowest risk, largest size, etc. | 1 | 2 | Medium risk, medium size, etc. | 3 | 4 | 5 | Highest risk, smallest size, etc. | 6 | 7 | | | | | |

The fiscal discipline of EEE7 governments, as measured by external debt as a percentage of GDP, ranges from 22 percent in Belarus to 66 percent in Serbia. The fiscal discipline of the Russian government remains high. The external debt stock of the remaining four countries ranges between 46-52 percent of GDP.

The index of political freedom categorizes Poland, Slovenia, Romania, Serbia, and Ukraine as "politically free" (Freedom House, 2009). Belarus and Russia are "not free." The Failed States Index (FSI) predicts Belarus, Russia, and Serbia are "in danger" of becoming failed states with Belarus the most at risk (Foreign Policy and The Fund for Peace, 2009). The EU members in the EEE7, Poland and Slovenia, on the other end of the FSI spectrum, are "stable" with Slovenia the most stable state. Romania, another EU member, and Ukraine are "borderline" FSI states. The Global Corruption Barometer indicates a significant level of corruption in all the EEE7 countries expect Slovenia, which was not included. Ukraine is perceived to be the most corrupt followed by Romania, Russia, and Serbia. Belarus and Poland are perceived to be the least corrupt of the EEE7 countries (Transparency International, 2009). The press freedom measure of Freedom House in 2009 has the Belarusian and Russian press as not free and among the least free in the

world. At the other end of the press freedom scale, the Polish and Slovenian press is free. The remaining three countries, the presses of Romania, Serbia, and Ukraine are ranked as only partly free.

*Economic Risk*

The structure of Eastern European economies are representative of emerging markets. Please see details in Table 2. The service sector accounts for less than 60 per cent of GDP, manufacturing for just over one-third of GDP, and agriculture for the remaining 7 per cent of GDP. Of the EEE7 economies, Poland and Slovenia have the largest service sector share, the CIS countries (Belarus, Russia, and Ukraine) have the largest industry sector share, and Serbia has the largest agriculture share. Slovenia, Poland, Russia have the smallest agriculture share, Serbia and Poland have the smallest industry share, and Belarus and Ukraine have the smallest service sector share.

Table 2: Economic Structure of Seven European Countries

**Economic Structure - 7 Eastern European Countries**

| | % of GDP | Agriculture | Industry | Services |
|---|---|---|---|---|
| **Belarus** | 2008 | 9 | 39 | 53 |
| **Poland** | 2008 | 4 | 30 | 65 |
| **Romania** | 2008 | 8 | 34 | 58 |
| **Russia** | 2007 | 5 | 38 | 57 |
| **Serbia** | 2007 | 13 | 28 | 59 |
| **Slovenia** | 2007 | 2 | 34 | 63 |
| **Ukraine** | 2008 | 8 | 37 | 55 |
| *Average* | | **7** | **34** | **59** |

**Source:** World Bank - HNPStats - Country at a Glance

A number of the EEE7 countries have not radically privatized, indeed have renationalized, their economies (Ivanova, 2004). It has is yielded rent-seeking economic interests. State-owned enterprises (SOEs) and collective agriculture remain predominant.

See Figure 4 showing the 5.5% share of world GDP of the seven countries in this study is significant when compared with the respective shares of the EU (21.6%), Central and Eastern Europea (3.5%), and CIS & Mongolia (4.7%). The Russian economy 3.34% accounts for the lion's share of each country group except the EU. Russia's GDP is over three-times larger than Poland, the second-largest economy in this study. Poland, in turn, is over two-times larger than the third-largest economy, Ukraine.

The economic risk variables listed below begins with the size of their economies, in terms of purchasing power parity (PPP) gross domestic product (GDP). The range of economic size of EEE7 economies, while wide, allows us to assess the relative conditions of different countries in the same region. The variables that follow differentiate the current economic risk picture.

Real economic growth is expected to decline in every country in 2009 with two of the larger economies, Ukraine and Russia, especially hard hit, with 8 percent and 6 percent declines, respectively. Signicant declines in economic growth rates, of over 4 percent, are also forecast for Belarus and Romania. The growth rates of the Slovenian and Serbian economies are predicted to decline by about half that much. Only the Polish economy is expected to contract by less than one percent.

Figure 4: Gross Domestic Product 2009 Forecast

**Gross domestic product based on purchasing-power-parity (PPP) share of world total**, 2009 forecast

| EEE7 | Central & Eastern Europe | CIS & Mongolia | EU |
|---|---|---|---|
| 5.5 | 3.5 | 4.7 | 21.6 |

**Source:** World Economic Outlook database, April 2009

There is also the added threat in 2009 of consumer price inflation, especially in Commonwealth of Independent States (CIS) countries and Serbia. Double-digit inflation is predicted for Ukraine, Russia, Belarus, and Serbia with Ukraine expected to experience almost 17 percent average annual inflation. Price inflation in Slovenia is almost steady. Poland and Romania are expected to average 2 percent and 6 percent inflation, respectively, in 2009 (reference Table 3 for more details).

In the external sector and the balance of payments, net payments for international trade for all the countries have net zero or negative relative to GDP. In other words, all the EEE7 countries have zero or negative trade balances. Serbia's trade balance to GDP rate registered the largest deficit, at over -12 percent. To compensate for its negative trade balance, the FDI share of gross fixed capital formation (GFCF) was a high 34 percent in Serbia in 2008. Belarus also has a large trade deficit, as well as high export dependence, indicating a positive relationship between balance of payments and domestic economic growth vulnerabilities. To compensate for external payments for net imports, net FDI inflows increased markedly increased in Belarus between 2005-2007. They also increased in Russia during the same period.

BMI assesses the short- and long-term economic risks in EEE7 countries, like their short- and long-term political risks, to be higher than the regional and emerging market averages, especially in the short-term. The riskiest economies are Ukraine, Serbia, and Belarus. Economic risk in the Ukraine is the highest in the short-term but less than Belarus' in the long-term. Belarusian economic risk is expected to deteriorate in the long-term. Serbia's risk profile is high and the outlook is not optimistic. Economic conditions in Romania are expected to deteriorate in the long-term. Economic risks in Poland and Slovenia are expected to lessen in the long-term. The economic risk outlook for Russia is the most upbeat, especially in the long-term.

The level of economic freedom of the EEE7 economies are similar to the BMI assessments of economic risk and the respective levels of EEE7 political freedom (Heritage Foundation, 2009). However, none of the seven economies are free. The economies of Romania, Slovenia, and Poland are only moderately free, followed by those of Serbia and Russia, which are mostly unfree. The Belarusian and Ukranian economies are repressed.

Table 3: Economic Risk Table

| Economic Risk Variables | | Belarus | Rank, Year | Poland | Rank, Year | Romania | Rank, Year | Russia | Rank, Year | Serbia | Rank, Year | Slovenia | Rank, Year | Ukraine | Rank, Year |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| PPP GDP, Current International Dollar, billions | | 114.79 | 2009f | 667.293 | 2009f | 261.57 | 2009f | 2,145.76 | 2009f | 78.831 | 2009f | 58.249 | 2009f | 312.755 | 2009f |
| Gross domestic product based on PPP share of world total, percent | | 0.18 | 2009f | 0.97 | 2009f | 0.41 | 2009f | 3.34 | 2009f | na | 2009f | 0.087 | 2009f | 0.479 | 2009f |
| Real GDP growth, annual rate | | -4.33 | 2009f | -0.75 | 2009f | -4.14 | 2009f | -5.98 | 2009f | -2.00 | 2009f | -2.70 | 2009f | -8.01 | 2009f |
| Inflation rate, consumer prices, average annual rate | | 12.64 | 2009f | 2.08 | 2009f | 5.95 | 2009f | 12.87 | 2009f | 10.04 | 2009f | 0.50 | 2009f | 16.77 | 2009f |
| Current Account Balance/GDP, percent | | -8.10 | 2009f | -4.48 | 2009f | -7.53 | 2009f | 0.52 | 2009f | -12.15 | 2009f | -3.98 | 2009f | 0.62 | 2009f |
| Exports of Goods and Services/GDP, percent | | 71 | 2008 | 37 | 2008 | 28 | 2008 | 33 | 2008 | 31 | 2008 | 70 | 2007 | 42 | 2008 |
| High-technology exports, percent of manufactured exports | | 3 | 2007 | 4 | 2007 | 4 | 2007 | 7 | 2007 | 4 | 2005 | 5 | 2007 | 4 | 2007 |
| Gross Domestic Savings/GDP, percent | | 18.9 | 2007 | 20.5 | 2007 | 9.6 | 2007 | 33.0 | 2007 | 4.8 | 2007 | na | | 18.8 | 2007 |
| Gross Capital Formation/GDP, percent | | 35 | 2008 | 23 | 2008 | 26 | 2008 | 25 | 2008 | 23 | 2008 | 31 | 2007 | 25 | 2008 |
| Foreign direct investment (FDI), net inflows, percent change | | 4.85 | 2005-7 | 1.23 | 2005-7 | 0.46 | 2005-7 | 3.27 | 2005-7 | 0.93 | 2005-7 | 1.75 | 2005-7 | 0.27 | 2005-7 |
| FDI/GFCF, percent | | 0.12 | 2007 | 0.23 | 2007 | 0.19 | 2007 | 0.17 | 2007 | 0.34 | 2007 | 0.10 | 2007 | 0.26 | 2007 |
| Economic Risk, Q4 2009 | Short-term | 45.8 | 35 | 58.8 | 24 | 53.3 | 25 | 53.1 | 28 | 34.6 | 48 | 50.6 | 30 | 27.1 | 50 |
| | Long-term | 41.0 | 46 | 58.5 | 27 | 47.8 | 37 | 65 | 17 | 43.5 | 43 | 60.8 | 20 | 42.5 | 45 |
| Economic Freedom (183 countries, 2009) | | 45, Repressed | 167 | 60.3, Moderately free | 82 | 63.2, Moderately free | 65 | 50.8, Mostly unfree | 146 | 56.6, Mostly unfree | 109 | 62.9, Moderately free | 68 | 48.8, Repressed | 152 |
| Global Competitiveness Report (134 countries, 2009-2010) | | na | | 4.33 | 46 | 4.11 | 64 | 4.15 | 63 | 3.77 | 93 | 4.55 | 37 | 3.95 | 82 |
| Finanical Development Report (52 countries, 2008, Score: 1-7) | | na | | 3.27 | 41 | na | | 3.40 | 36 | na | | na | | 2.73 | 51 |
| Global Information Technology Report (134 countries, 2008-2009) | | na | | 3.80 | 69 | 3.97 | 58 | 3.77 | 74 | 3.62 | 84 | 4.57 | 31 | 3.88 | 62 |
| Group Rank: Relative Risk, Size, etc. | Lowest risk, largest size, etc. | 1 | 2 | Medium risk, medium size, etc. | 3 | 4 | 5 | Highest risk, smallest size, etc. | 6 | 7 | | | | | |

*Business Risk*

The assessments of business risk (see Table 4) are more positive than the previous risk assessments. It begins with the BMI assessment of the business environment, which, while determining the EEE7 business environment is less attractive than the rest of the region, is better than the emerging market average and even slightly better than the global average. The UN transnationality index bears this out, showing FDI was as important in Romania, Poland, Slovenia, and Ukraine as it was in the rest of Europe in 2005. Only Serbia, Russia, and Belarus do not host FDI to the extent that it affects the domestic economy. This changed after 2005, as discussed above.

The last three categories of business risk are from the World Bank Group and include: Market capitalization as a percent of GDP, Time required to start a business, and the "Ease of Doing Business" indicators. These are easily the most surprising indicators thus far in the risk analysis. Indeed, they are leading risk indicators, in particular the connection between market competitiveness and policy responses at the national level. The first World Bank indicator, stock market capitalization, illustrates the dramatic decline of business conditions of the publicly listed

companies in EEE7 countries between 2007 and 2008. The exception is Russia, where the trend was positive and dramatically so, appreciating by over 50 percent. Otherwise, the market value of EEE7 firms declined, by as much as 38 percent in Slovenia.

Table 4: Business Risk Variables

| Business Risk Variables | Belarus | Rank, Year | Poland | Rank, Year | Romania | Rank, Year | Russia | Rank, Year | Serbia | Rank, Year | Slovenia | Rank, Year | Ukraine | Rank, Year |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Business Environment Risk | 36.5 | 42 | 57.6 | 25 | 52.1 | 31 | 46.8 | 35 | 50.8 | 34 | 66.6 | 13 | 45.8 | 37 |
| Transnationality Index, 2005 | 3.3 | 2005 | 21.0 | 2005 | 22.8 | 2005 | 11.8 | 2005 | 16.4 | 2005 | 13.6 | 2005 | 22.3 | 2005 |
| Market capitalization of listed companies (% of GDP) | na | 2008 | 17.1 | 2008 | 10.0 | 2008 | 82.2 | 2008 | 24.3 | 2008 | 21.6 | 2008 | 13.5 | 2008 |
| | na | 2007-8 | -13.9 | 2007-8 | -4.0 | 2007-8 | 52.2 | 2007-8 | 1.3 | 2007-8 | -38.4 | 2007-8 | -13.5 | 2007-8 |
| Time required to start a business (days, 2008) | 31 | | 31 | | 10 | | 30 | | 23 | | 19 | | 27 | |
| | -17 | 2007-8 | 0 | 2007-8 | -4 | 2007-8 | 0 | 2007-8 | 0 | 2007-8 | -41 | 2007-8 | 0 | 2007-8 |
| Ease of "Doing Business" (183 countries, 2010) | 24 | 58 | 0 | 72 | -10 | 55 | -2 | 120 | 2 | 88 | 5 | 53 | 4 | 142 |
| Starting (registering) a business | 91 | 7 | 28 | 117 | -12 | 42 | -18 | 106 | 35 | 73 | 16 | 26 | -8 | 134 |
| Dealing with construction permits | 19 | 44 | -7 | 164 | -4 | 91 | 0 | 182 | -2 | 174 | 10 | 59 | 0 | 181 |
| Employing workers | 8 | 32 | -7 | 76 | -3 | 113 | -5 | 109 | -7 | 94 | -3 | 162 | 7 | 83 |
| Registering Property | 3 | 10 | -2 | 88 | 20 | 92 | 5 | 44 | -6 | 105 | -2 | 108 | 3 | 141 |
| Getting Credit | -4 | 113 | 12 | 15 | -3 | 15 | 22 | 87 | 8 | 4 | -3 | 87 | -3 | 30 |
| Protecting Investors | -4 | 109 | -3 | 41 | -3 | 41 | -5 | 93 | -3 | 73 | -1 | 20 | 34 | 109 |
| Paying taxes | 0 | 183 | -4 | 151 | -1 | 149 | 5 | 103 | -11 | 137 | -6 | 84 | 1 | 181 |
| Trading across borders | 5 | 129 | -1 | 42 | -3 | 46 | -2 | 162 | -2 | 69 | -2 | 84 | 0 | 139 |
| Enforcing contracts | 2 | 12 | -4 | 75 | -25 | 55 | 0 | 19 | -2 | 97 | 20 | 60 | 3 | 43 |
| Closing a business | 0 | 74 | 0 | 85 | -3 | 91 | 0 | 92 | 0 | 102 | 0 | 40 | 0 | 145 |
| Group Rank: Relative Risk, Size, etc. | Lowest risk, largest size, etc. | 1 | 2 | Medium risk, medium size, etc. | 3 | 4 | 5 | Highest risk, smallest size, etc. | 6 | 7 | | | | |

The policy response to the crisis is most evident with the easing of registration regulations for business start-ups. The days required to start a business dropped by as many as 41 days in Slovenia, 17 days in Belarus and 4 days in Romania. Data from the other countries is unchanged between 2007 and 2008.

Finally, the 2010 "Ease of Doing Business" survey concludes that while Slovenia, the most developed economy in the EEE7 is the best place to do business, so are Romania and Belarus. In fact, business conditions in Belarus improved dramatically between 2007 and 2008, especially in the ares of getting construction permits, employing workers, registering property, and enforcing contracts.

*Societal Risk*

The societal risk variables rounds out the risk analysis and give the most important indications of long-term risk (see Table 5). The combined population of the EEE7 countries declined from under 270 million people in 2008 to over 265 million in 2009, indicating signification emigration from those countries. Serbia, in particular, relies heavily on remittances from overseas. Ex patriot remittances are also important contributors to the GDPs of Romania and Ukraine.

There is a very wide disparity in their respective PPP GDP per capita and gross national income (GNI) per capita. Consumers in tiny Slovenia are the best, followed by Poland, Russia,

Romania, Serbia, Belarus, and Ukraine, in that order. Unemployment rates in the EEE7 countries in mid-2009 averaged 8.3 percent, up from 7.1 percent a year ago. Unemployment ranged between 0.9 – 15.6 percent, with Belarus reporting the lowest rate and Serbia the highest.

Table 5: Societal Risk Variables

| Societal Risk Variables | Belarus | Rank, Year | Poland | Rank, Year | Romania | Rank, Year | Russia | Rank, Year | Serbia | Rank, Year | Slovenia | Rank, Year | Ukraine | Rank, Year |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Population, Persons, millions, 2009 forecast | 9.575 | | 38.079 | | 21.415 | | 141.391 | | 7.382 | | 2.016 | | 45.505 | |
| PPP GDP per capita, Current International Dollar, 2009 forecast | 11,989 | | 17,524 | | 12,214 | | 15,176 | | 10,679 | | 28,898 | | 6,873 | |
| GNI per capita, Atlas method, current US$, 2008 | 5,380 | | 11,880 | | 7,930 | | 9,620 | | 5,700 | | 24,010 | | 3,210 | |
| Unemployment rate, % of total labor force, ytd 2009 | 0.9 | H1 2009 | 7.9 | Q2 2009 | 6.3 | Jul-09 | 8.3 | Jul-09 | 15.6 | Apr-09 | 9.4 | Jul-09 | 10.0 | Jul-09 |
| Life expectancy, 2007 | 70 | | 75 | | 73 | | 68 | | 73 | | 78 | | 68 | |
| Human Development Index (HDI) (179 countries: 1-75, High; 76-153, Medium; 154-179 Low) | 0.817 | 67 | 0.875 | 39 | 0.825 | 62 | 0.806 | 74 | na | | 0.923 | 26 | 0.786 | 82 |
| Gender Gap Report | 0.7099 | 33 | 0.6951 | 49 | 0.6763 | 70 | 0.6994 | 42 | na | | 0.6937 | 51 | 0.6856 | 62 |
| Workers' remittances per capita/GNI per capita, percentage, 2008 | 0.01 | | 0.02 | | 0.06 | | na | | 0.13 | | 0.01 | | 0.04 | |
| Group Rank: Relative Risk, Size, etc. | Lowest risk, largest size, etc: 1 2 | | Medium risk, medium size, etc: 3 4 5 | | | | Highest risk, smallest size, etc: 6 7 | | | | | | | |

The United Nations human development index (HDI), which measures standard of living by qualitative indicators such as education, health care, life expectancy, etc. indicates the overall level of human development for all the EEE7 countries is high. The life expentancy of people in those countries also suggests this. Only Ukraine has a medium level of human development. HDI data for Serbia is not available.

The World Economic Forum's Gender Gap report indicates the gender gap is narrowest in the neighboring countries of Belarus, Poland, and Russia, as well as Slovenia. It is widest in neighboring countries Romania and Ukraine. Data for Serbia is again unavailable

## Eastern European Entrepreneurship Survey

After assessing the state of entrepreneurship in Eastern Europe at the macro-level we are now prepared for firm-level analysis. The survey portion of this study continues survey research begun by Hisrich, et al. in Ukraine (2006) and Welsh and Dragusin in Romania (2006). A revised survey was prepared to take into account the macro risk variables discussed above and implement the 'avenues of participation' methodological framework. The object of the survey and is to determine which avenue of participation is open, which is restricted, and/or which is closed?

The survey has three sections and fourteen questions. Section 1, General information and current market conditions asks eight questions and begins by asking the firm's industry to find out whether or not the SME population is representative of the overall economy. The World Bank Group reports an almost perfect asymmetry in the business distribution in developing and industrialized countries. While in developing countries the retail and finance sectors are twice as big as in the industrialized countries, the industry and services sectors are half their size (Klapper et al., 2007).

The first section also asks the age, number of employees, geographic scope of the firm to assess SME sustainability and thereby addresses the question of market sustainability. This addresses the openness of the first avenue of participation, state presence in the market. The last three questions of the first section address the competitive dynamic in each country's market; whether or not it is changed in the last five years and, if so, how. This addresses the openness of the second avenue of participation, the regulatory environment.

The second section asks questions about the firm's competitive environment and the conditions affecting the firm's success, in particular, expansion and financing decisions, market dynamics, both positive and negative, and determinants of its short- and long-term (five-year plus) profitability. This addresses the openness of the third avenue of participation, market competitiveness.

The final section of the survey is not numbered and is titled, "A few words about me." The questions in this section are also not numbered. The aim is to conclude the survey with more personal questions, which may motivate him/her to complete it. It asks their age, position in and ownership share of the firm, work load, education, and for a self-assessment of management skills. A few questions country-specific questions such as EU trade relations are tacked on at the end.

The survey has been translated English, Russian, and Serbian and is published on Survey Monkey, a platform that makes surveys easy to take, as well as collect data.

## Challenges of International Analysis

The first challenge is to obtain a representative list of small and medium enterprises (SMEs). We are requesting lists of newly registered firms from national business registries (Belarus: Belarusian Business (Bel.Biz); Poland: World Bank, Romania: Registrar of Corporations, Office of Attorney General; Russia: Russian SME Resource Center; Serbia & Montenegro: Department of Statistical Registers and Standards; Slovenia: AJPES; Ukraine: State Statistics Committee of Ukraine) (see Klapper et al., 2007). The World Bank study finds the level of good governance (political, institutional, and tax reform), low corruption, and ease of starting a business are significant indicators of total firm registration (Klapper, et al., 2007). We are also contacting SME professional associations, entrepreneurship scholars and research institutions in those countries.

The primary challenge of international surveys is the participation rate. Any number of factors affect survey participation – the type of questions, the experience entrepreneurs have with surveys including incentives, if necessary, to take them, the level of transparency business principals are comfortable with, and the manner in which the survey is conducted.

A visit of Belarusian women entrepreneurs and their relaying of the formidable barriers to entrepreneurship was the inspiration to extend the Eastern European entrepreneurship. But conducting the survey in Belarus was particularly challenging. Indeed, the difficulties we experienced conducting the survey in Belarus were overwhelming and severely impeded the research. Despite having met the Belarusian ladies face-to-face, in the company of two Russian translators, we could not maintain contact with them after they returned to Belarus. We sent

email and posted letters with a link to the survey website asking them to take the survey and to ask other SME principals and groups they knew to do the same. Only one person took the survey. We contacted the program sponsor of their visit at the US Department of State to ask for advice and they said the fear of communicating with us was a probable explanation for the lack of participation. US-Belarusian relations had taken a dramatic turn for the worse in the interim and the Belarusian government ordered the US Embassy in Minsk to halve its staff in March, 2008. The US responded by implementing economic sanctions and reauthorizing the Belarus Democracy Act in June, 2008 (H.R. 5970).

Foreign policy is an important independent variable affecting political risk, which spreads to other types of risk. Security, including energy security, is the primary driver of Belarus' foreign policy. It is heavily influenced by its eastern neighbor, Russia. Belarus is Russia's closest ally among ex-Soviet states and has long been dependent on Moscow for energy supplies, security assistance, and economic subsidies. The Belarusian capital, Minsk, is also the CIS capitol. At the end of 2007, Russian President Vladimir Putin announced the "merger" – a full scale union between Russia and Belarus. Almost simultaneously, Russian SOE, Gazprom announced a new round of natural gas hikes that would triple the price Belarus paid for natural gas a year earlier (Wier, 2007). Another "shoe dropped" six months later when Belarusian president, Alexander Lukashenka, named Vladimir Putin the prime minister of the Russia-Belarus alliance. Amid bilateral trade disputes since 2007, most recently over Belarusian dairy exports to Russia, Belarus assumed the chairmanship of the Collective Security Treaty Organization (CSTO) in 2009.

In an attempt to curtail Russia's influence in the Eastern Europe and Central Asia, the EU announced an Eastern Partnership initiative in May, 2009, which aims to improve relations with countries that could help the EU diversify its energy supplies – Armenia, Azerbaijan, Belarus, Georgia, Moldova, and Ukraine. The European Council's "Joint Statement of the Prague Eastern European Partnership Summit" the main goal is to create the necessary conditions to accelerate political association and further economic integration between the EU and interested parties (European Council, 2009).

The risk analysis above indicates conditions in Belarus are probably the worst among the EEE7 countries. The cumulative privatization revenue as a percent of GDP is much lower in Belarus than in other transition economies in Central and Eastern Europe (Kirchner and Guicci, 2009). Between 75-80 percent of Belarus' economy remains in state hands (Denyshenko, 2008). Belarus has the highest government participation in ownership rate in private firms in Eastern Europe and Central Asia (WBG, 1/1/2009). Belarusian firms are also large in comparison with those in the region, averaging 91 employees, twice the regional average (WBG, 1/1/2009).

The strong state presence in the Belarusian economy is symptomatic of the iron-fisted rule of the country's 15-year president, Alexander Lukashenka, described by one official as "a period of strong government needed to consolidate independence" (Barber, 2008)." Lukashenka renationalized the companies, including banks, which had been privatized after independence, using a so-called "Golden Share" mechanism, the right of the state to govern joint stock companies (DOS, 2/08, 4*)*. Despite its limited use, the "Golden Share" mechanism negatively influenced the investment climate (Kirchner and Guicci, 2009). The Belarusian government, in

an apparent policy reversal, hosted the first Belarus Investment Forum in November 2008. The Belarusian Prime Minister, Sergei Sidorsky, announced that some 600 companies were slated for privatization, as well plans to streamline business regulations and reform the tax code (Denysenko, 2008). While the Lukashenka government eased political controls in October 2008, they were tightened again early 2009 (Barber, 2009). The financial crisis strained Belarus's economy to the limit (Barber, 2009). Privatization has consequently ground to a halt since the financial crisis began to affect Belarus at the end of 2008 and the 2009 outlook is cloudy with no new deals reports (Kirchner and Guicci, 2009). Nevertheless, the Belarusian government insists that privatization and attracting foreign investment are policy priorities.

The leading indicator, the business environment, is more positive for Belarus than are its preceding risk assessments. It is important, however, to remember that, while business risk may be a leading indicator, it may be quickly reversed if the Belarusian government opts to return to tight control of the private sector.

## Conclusion

Societies balance between tradition and change, confidence and uncertainty, tolerance and intolerance, competitiveness and complacency, security and insecurity (Weiss, 2009). Innovation – "building a better mouse trap" – self-determination, independence, living a better life motivates entrepreneurs as much as the profit motive (Weiss, 2009). The economic crisis has raised questions about market capitalism and made global entrepreneurship even more necessary but also perhaps more vulnerable.

EEE7 countries and the Eastern European region as a whole continue to weather the effects of the global crisis. While the risk variables listed above are numerous and require further analysis, there are positive signs in all countries. Some of the countries, Slovenia and Poland, in particular appear to have weathered the crisis fairly well thus far. The prognosis for Belarus, Ukraine, and Serbia, at the other extreme, is not optimistic. The indicators for Romania and Russia are more variable.

While macroeconomic conditions appear to be sufficiently uncertain for private sector development to be seen as a way out of the crisis, they vary across countries and the long-term effects of the crisis are uncertain. Long-term political risks may return. The societal risk indicators bear this out. The foreign policy risk variable, especially energy pipeline politics, remains extremely high in the countries sandwiched between the EU and Russia. It is therefore not surprising that their other risks remain high and their outlooks are the most pessimistic.

The difficulty we had conducting the surveys, while frustrating, is instructive. The conditions facing small and medium enterprises in Eastern Europe continue to be very difficult. Having heard first-hand from the Belarusian entrepreneurs, where the situation is among the worst, about the odds they face and that they nevertheless persevere made a lasting impression. The global economic crisis that occurred in the meantime has shaken up the status quo and increased the level of uncertainty. Yet, it is now more important than ever to foster and sustain entrepreneurship because of its benefits for recovery. The challenges of international analysis notwithstanding, researchers in this area have to remain equally motivated to keep lines of communication open internationally and especially, among entrepreneurs in their home country.

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# AN ANALYSIS OF FUNDING DECISIONS FOR NICHE AGRICULTURAL PRODUCERS

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## Introduction

Capital acquisition is difficult for all small firms, but especially challenging for agricultural entrepreneurs (Richards and Bulkley, 2007; Ang, 1992). Capital acquisition decisions have significant implications for business operations, risk, and performance (Cassar, 2004). Insufficient or inappropriate combinations of capital can lead to firms not being able to acquire needed assets and successfully compete (Coleman, 2000; Wiklund and Shepherd, 2005; Carter and Van Auken, 2006). Owners of small firms often lack business skills and do not understand the process through which capital is raised. As a consequence, owners evaluate an incomplete set of capital alternatives and select an inappropriate combination of capital (Van Auken, 2001).

This paper examines the flow of funds from providers of capital to niche agricultural users of capital. Few studies have examined this aspect of capital flows despite the importance of the overall agricultural industry and niche producers. The US currently has about 2.1 million farms that operate about 1 billion acres of land. Approximately 25% of the farms and 15% of the acres are located in the Midwest. Approximately 99% of these farms and farm acres are family-owned enterprises. Small farms, defined as farms with less than $20,000 in annual sales, comprised about 60% of all farms and 29% of US agricultural land held by farmers in the US. Entrepreneurship is recognized as an important aspect and competitive advantage of modern farming operations (Richards and Bulkley, 2007; Steele, 1997). The US organic industry, one sector of the US agricultural industry, grew about $20 billion in sales in 2007 and is expected to reach about $23.6 billion in sales in 2008. Sales of organic food products comprise about 2.8% of the total US food sales in 2006, and are growing about 20% per year (Organic Trade Association, 2007).

## Small Firm Capital Acquisition

*Information as a Financing Constraint*

The validity of corporate finance theory in the context of the small firm has been questioned because small business owners attempting to raise capital are confronted with a number of challenges that include awareness of potential sources of capital, knowledge of the relationship between the business characteristics and capital acquisition, and understanding the capital acquisition process (Ang, 1992; Ang, 1991; Barton and Gordon, 1988; Barton and Mathews, 1989). Several studies (Kuratko, Hornsby, and Naffiziger, 1997; Landstrom, 1992) argued that lack of information about capital acquisition may be an important obstacle confronting the entrepreneur's acquisition of capital.

Gibson (1992) believes that owners' search for capital is often inefficient, unorganized, and unsuccessful as a result of their lack of information about the alternative sources of funding. Busenitz et al (2003) suggest that the availability of information impacts financing decisions. This includes information about alternative sources of capital as well as the process through which capital is acquired (Berger and Udell, 1998; Gibson, 1992). Chaganit, DeCarlis, and

Deeds (1995) emphasized that capital that is easier to acquire is used more often while capital that is more difficult to acquire is used less often. A lack of information about capital alternatives may result in small firms being under-capitalized and have limited market potential (Van Auken, 2001; Becchetti and Trovato, 2002).

Chrisman and McMullan (2004) contended that technical assistance from external advisors can be important in assisting small business owners to raise capital. Outsider assistance can provide unbiased and useful information that helps entrepreneurs to understand the process of capital acquisition. Audet and St-Jean (2007) reported that entrepreneurs typically do not fully utilize the advice services that are available. Use of the services was found to increase with greater knowledge of the availability of the service. External assistance can provide business owners with tools necessary to become successful in acquiring capital (Chrisman, 1999; Lang, Calantone and Gudmundson, 1997). Berger and Udell (1998) suggested that the relationship between the small firm and provider of capital impacts flow of information, terms of funding, and success in acquiring capital.

*Financing Niche Agricultural Firms*

Availability of capital has historically been a problem in rural markets (Sherrick, 1998). Accessing capital is especially challenging for niche agricultural firms because their business does not fit the traditional business model evaluated by providers of capital (Richards and Bulkley, 2007).

Commercial banks play an important role in providing not only capital, but also information to rural customers. Facilitating the flow of information is important because the capital gap has been attributed to knowledge and skills in rural markets (Drabenstott and Meeker, 1997). Wheatley (2001) emphasized how the difficulty of capital acquisition can put niche agricultural producers at a competitive market disadvantage. The challenge of capital acquisition has been cited as a critical challenge for niche agricultural producers (Pirog et al, 2006). Niche agricultural producers may be especially limited in their access to information related to understanding alternative financing alternatives as well as the process of capital acquisition (Fries and Akin (2004). Limited access to consistent and reliable sources of capital is especially relevant for firms operating in niche agricultural markets. Holmes and Kent (1991) refer to the limited awareness of capital alternatives in the context of a "knowledge gap". The problem may be related to awareness about which sources of capital are available and appropriate, and an understanding by providers of capital about how to evaluate requests for funding from small niche market agriculture firms.

## Methodology

*Sample and Questionnaire*

A focus group was initially convened to discuss issues related to capital acquisition among niche agricultural producers. Focus group participants include owners of niche agricultural businesses, economic development personnel, and providers of capital. Information learned from the focus group was integrated with previous research studies, including Van Auken (2005), Carter and Van Auken (2005), Busenitz et al, (2003), Kuratko, Hornsby, and Naffiziger (1997), McMahon and Stanger (1995), Petty and Bygrave (1993), Ang (1992), to develop a questionnaire. The questionnaire was initially developed and pre-tested in fall 2007.

The questionnaire was divided into three sections: (1) characteristics of providers of capital and (2) information related to funding of proposal. In the first section, respondents were asked to identify their organization (Community Development Financial Institution, Council of Governments, Farm Credit Services, Resource Conservation & Development Non-Profit Corporation, USDA, Rural Development Fund, Revolving Loan Fund); year fund was established,; percent of total funds committee, number of investments made per year over the past three years, and eligibility criteria.

The second section of the paper asked the respondent to indicate types of funding extended (loans that must be repaid within a year, loans with 1-5 year payback term, loans with payback terms longer than 5 years, grant, equity investment, line of credit) and type of technical assistance provided (recognizing opportunities, preparing business plan, finance, marketing, legal, accounting/bookkeeping, human resources, business strategy, auditing).

Surveys were sent to 138 providers of capital throughout Iowa. Isolating the sample to a single state has several advantages. First, focusing on a single state facilitates data collection. This rationale is especially relevant when focusing on specialized niches businesses that are more relevant to the state than for other states. All types of capital providers were included in the sample. Focusing on only a single state also minimized the number of extraneous variables. For example, states may have different funding programs and provide different levels of support. A total of 56 usable questionnaires were returned, providing a response rate of 40.6%.

*Analysis*

The results were initially summarized using univariate statistics (means and percentages) to provide a better understanding of the respondents. This was completed for all questions in the survey.

Subsequently, two logit regression models were used in the analysis. The dependent variable in the second regression was the percentage of funds that are committed by the agencies. The independent variables were age of fund (control variable), type of fund (control variable), rejection because of lack of collateral (independent variable), and whether the applicant had a business plan (independent variable).

$$\text{Percent of Funds} = a_0 + b_1\,\text{Age} + b_2\,\text{Type} + b_3\,\text{Collateral} + b_4\,\text{PlanCommitted}$$

Where:

age = age of agencies

type = type of agency

(1 =community develop. fin. institution, farm credit service, resource conservation & develop. corp. revolving loan fund

(2 =council of governments USDA rural development fund )

collateral=lack of collateral reason for loan rejection

plan=weak bus plan reason for loan rejection

The dependent variable in the second regression was the number of applications funded by the agencies. The independent variables were age of fund (control variable), reasons for rejection (independent variable), and whether the fund provided technical assistance (independent variable).

Number of Applications Funded = $a_0 + b_1$ Age+ $b_2$ Reason + $b_3$ Assistance

Where:

age = age of agencies
type = reason for rejection (weak plan + risk)
assistance = 1 if agency provided technical assistance
0 if agency provided no technical assistance

**Table 1. Percent of Respondents from Agencies (n=56)**

| Agency | Percent of Sample |
|---|---|
| Revolving Loan Fund | 34.0 |
| Resource Conservation & Development | 14.2 |
| Council of Government | 12.5 |
| Rural Electric Cooperative | 10.7 |
| USDA | 7.1 |
| Community Development Financial Institution | 7.1 |
| Rural Development Fund | 3.6 |
| Farm Credit Services | 5.4 |
| Other | 5.4 |

## Results

*Background*

Table 1 shows the percent of respondents by type. Most respondents were from revolving loan funds (34%). The percent of respondents among other providers of capital were resource conservation & development (14.2%), council of government (12.5%), and rural electric cooperative (10.7%). Less than 10% of the other responding providers were from each of the other types of firms.

*Increasing Flow of Funds to Niche Agricultural Producers*

Table 2 shows the percent of each agency recommendation for methods to increase the flow of funds to niche producers. More technical assistance was recommended by the majority of respondents, followed by more available capital and greater dissemination of information. More government involvement was the least recommended method of increasing the flow of funds to niche producers.

| Table 2. Methods to Increase Flow of Funding to Niche Agricultural Producers: Percent of Responses for Each Method (Multiple Responses Possible) (n=56) | | | | |
|---|---|---|---|---|
| **Agency** | **Technical Assistance** | **Government Involvement** | **More Capital** | **Greater Dissemination of Information** |
| Community Development Financial Institution | 75.0 | 0 | 25.0 | 25.0 |
| Council of Governments | 28.6 | 14.3 | 28.6 | 14.3 |
| Farm Credit Services | 33.3 | 0 | 0 | 0 |
| Resource Conservation & Development | 37.5 | 25.0 | 37.5 | 12.5 |
| USDA | 75 | 25.0 | 50.0 | 75.0 |
| Rural Development Fund | 50 | 50.0 | 0 | 50.0 |
| Revolving Loan Fund | 36.8 | 10.5 | 36.8 | 26.3 |
| Rural Electric Cooperative | 66.7 | 16.7 | 16.7 | 0 |
| Other | 16.7 | 0 | 33.3 | 0 |
| Over Mean for all Agencies | 41.1 | 14.3 | 30.3 | 21.4 |
| Overall Average | 40.0 | 14.5 | 29.1 | 20.0 |

*Technical Assistance*

Table 3 shows the percentage of each agency offering specific types of technical assistance. Few of the agencies offer technical assistance. Assistance with business plans and financial help were the most common types of assistance provided. Many of the specific types of assistance were not provided by the agencies.

*Rejection of Funding Application*

Table 4 shows the percentage of each agency's reason for rejecting funding applications. The highest percentage of reason for not approving a funding request was because of insufficient collateral, weak/no business plan, high risk, and fund criteria not met. All other reasons were indicated by a much lower percentage of agencies.

| Table 3. Percent of Agency Indicating Reasons Why Funding Request Was Rejected (n=55) | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Agency** | **Insufficient Collateral** | **Loan Request too Small** | **Loan Request too High** | **Fund Criteria not met** | **Weak or No Business Plan** | **Risk too High** | **Owner In-experience** | **Low Credit Score** |
| Community Development Financial Institution | 25 | 0 | 0 | 25 | 25 | 50 | 25 | 0 |
| Council of Governments | 14.3 | 0 | 0 | 14.3 | 28.6 | 14.3 | 14.3 | 0 |
| Farm Credit Services | 33.3 | 0 | 0 | 33.3 | 33.3 | 67.7 | 0 | 66.7 |
| Resource Conservation & Development | 42.9 | 0 | 14.3 | 14.3 | 28.6 | 28.6 | 0 | 14.3 |
| USDA | 75.0 | 0 | 0 | 50.0 | 75.0 | 0 | 25.0 | 0 |
| Rural Development Fund | 50.0 | 50.0 | 0 | 50.0 | 50.0 | 0 | 50.0 | 0 |
| Revolving Loan Fund | 47.4 | 5.3 | 15.8 | 26.3 | 47.4 | 31.9 | 15.8 | 21.0 |
| Rural Electric Cooperative | 100 | 33.3 | 66.7 | 83.3 | 100 | 66.7 | 50.0 | 16.7 |
| Other | 66.7 | 0 | 33.3 | 67.7 | 66.7 | 66.7 | 0 | 0 |
| Over Mean for all Agencies | 50.9 | 7.2 | 16.4 | 34.5 | 49.1 | 34.5 | 18.1 | 14.5 |

*Variables Affecting Number of Applications Funded*

Table 5 shows the results of the regression analysis (F = 9.04, significant at 1%) where the dependent variable is number of applications funded; control variable is age of agency, and independent variables are reasons for rejection of application and whether the agency provided technical assistance. Table values show that the coefficients for reasons for rejection (coefficient = -0.473) and age of agency (coefficient=0.015) were significant at 1%. Whether assistance is provided by agency was not significant.

| Table 4 Percent of Each Agencies Providing Indicated Technical Assistance (n=56) | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Agency** | **Opportunity Recognition** | **Business Plan** | **Financial** | **Marketing** | **Legal** | **Accounting** | **HR** | **Strategy** | **Auditing** | **Other** |
| Community Development Financial Institution | 0 | 50.0 | 25.0 | 25.0 | 0 | 25.0 | 0 | 25.0 | 0 | 0 |
| Council of Governments | 14.3 | 0 | 28.6 | 14.3 | 0 | 0 | 0 | 14.3 | 0 | 14.3 |
| Farm Credit Services | 33.3 | 66.7 | 66.7 | 0 | 0 | 33.3 | 0 | 33.3 | 0 | 0 |
| Resource Conservation & Development | 42.9 | 42.9 | 14.3 | 28.6 | 0 | 28.6 | 14.3 | 14.3 | 0 | 28.6 |
| USDA | 75.0 | 25.0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 50.0 |
| Rural Development Fund | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 50.0 |
| Revolving Loan Fund | 21.1 | 15.8 | 10.5 | 5.3 | 0 | 0 | 0 | 10.5 | 0 | 5.3 |
| Rural Electric Cooperative | 0 | 33.3 | 0 | 33.3 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other Agency | 16.7 | 16.7 | 16.7 | 16.7 | 16.8 | 16.7 | 0 | 16.7 | 0 | 16.7 |
| Over Mean for all Agencies | 23.6 | 23.6 | 16.4 | 12.7 | 1.8 | 9.1 | 1.8 | 12.7 | 0 | 14.5 |

| **Table 5. Regression Analysis Results**<br>**Independent Variable = Number of Applications Funded**<br>**Independent Variables = Reasons for Rejection and Assistance Offered**<br>**Control Variable = Year Fund Established**<br>**(n=54)** | | |
|---|---|---|
| **Dependent Variable** | **Independent Variable** | **Regression Coefficient** |
| Number of Applications Funded<br>(F value = 5.70 **) | Intercept<br>Reasons for Rejection<br>Assistance<br>Year | 13.454 **<br>-0.273 **<br>-0.290 **<br>0.000 |
| ** Significant at p<.01 | | |

*Variables Affecting Percent of Funds Committed*

Table 6 shows the results of the regression analysis (F = 1.53) where the dependent variable is percentage of total agency funds committed; control variables are age of agency and type of agency (government or private), and independent variables are rejection because of lack of collateral and rejection because of weak/no business plan. Table values show that the coefficient for lack of collateral (coefficient = -21.10 is significant at 1%. Other variables are not significant.

| Table 6. Regression Analysis Results<br>Dependent Variable = Percentage of Funds Committed<br>Independent Variables = Age of Organization, Type of Organization, Application Rejected Because of Collateral, and Application Rejected Because of No/Weak Business Plan<br>(n=34) | | |
|---|---|---|
| **Dependent Variable** | **Independent Variable** | **Regression Coefficient** |
| Percentage of Funds Committed (F value = 1.53) | Intercept | 17.34 |
| | Age | 0.18 |
| | Type of Organization | -8.75 |
| | Collateral | 14.71 |
| | Business Plan | -21.10* |
| * Significant at p<.05 | | |

## Conclusions

The challenges associated with capital acquisition are well known. Small firms, regardless of the industry, are confronted with limited capital sources and often lack strong business skills and thus have a weak understanding of the process through which capital is raised and providers of capital make decisions. The importance of agricultural in the US and Iowa as well as the growth of niche agricultural markets suggests that communities and governments should develop policies and facilitate the flow of capital to help firms be successful.

The study shows that lack of collateral, business plan weakness, and risk are common reasons that funders reject applications. The funders believed that more technical assistance would increase the flow of capital to niche agricultural producers. However, few of the funders provide technical assistance.

The number of applications funded was significantly associated with rejection due to a combination of business plan weakness and high risk. The percentage of the agency funds committed was significantly associated with whether the applicant had a business plan.

The results of this study provide managerial implications that can be used by funding agencies and niche agricultural producers to better understand obstacles to capital acquisition. Agencies may better understand the lack of technical assistance advice, especially because of the role of technical assistance in developing business plans, financial strategies, and collateral requirements.

The limitations of the study provide opportunity for future research. The sample was small and only examined agencies that were located in the Iowa. Future research could examine similar issues in other regions of the country and provide comparative results. In addition, the data was collected at a single point in time. A longitudinal study could provide evidence in the changing patterns and variables impacting acquisition of finance by niche agricultural producers over time. A similar study across different countries would provide insight into the role and expectations of agencies by region of the world.

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# USING QUICKBOOKS® TO MANAGE THE SMALL BUSINESS: THE EFFECT OF REPORT USE ON ACCOUNTS RECEIVABLE

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## Abstract

This study presents the first known empirical evidence on the use of QuickBooks® software for management of a small business, specifically its accounts receivable. Lower levels of accounts receivable facilitate cash flow, a critical factor in small business viability. Results from a sample of small businesses show that although nearly half of small business owners failed to use the accounts receivable reports function, higher frequency monitoring was a significant predictor of lower accounts receivable balances. Implications of these findings for management practice and for small business counselors are discussed.

## Introduction

Collection of monies owed is an important factor in the survival of small firms (Wu and Young, 2002). Money still owed by customers for services or products is known as a business's accounts receivable. Higher accounts receivable balances decrease the amount of cash available to small businesses with direct effects on small business viability.

QuickBooks® is an accounting software program widely employed by small businesses. Yet there is no empirical evidence on its use in small businesses to perform management accounting tasks such as the management of accounts receivable.

The purpose of this study was to address this gap by examining the use of QuickBooks® for management of accounts receivable in small businesses through the monitoring of appropriate reports. Findings will be useful to small business owners and counselors by providing a benchmark on the extent to which QuickBooks® is currently employed for accounts receivable management along with empirical evidence of its benefits for a sample of small business owners.

In the next section of this paper, we briefly review the relevant literature on QuickBooks® and management accounting in small businesses, along with the hypothesis tested in this study. We then present the methodology employed for this research, results, and, finally, discussion of our findings, including implications for practice.

## Review of the Literature

Management of accounts receivable is an important factor to the survival of small companies (Wu and Young, 2002). Accounts receivable can have a major impact on the amount of cash available to the business, commonly called cash flow. Cash flow is one of the most commonly cited problems of small businesses.

Among small businesses with fewer than 20 employees, cash flow ranks among the top ten issues that these businesses face, with the smallest businesses ranking it highest (Phillips and Wade, 2008). Cash flow problems stem from a variety of sources such as seasonality, difficulty in collecting money owed, unexpected fluctuations in sales, investment in growth (Dennis, 2001). Small businesses can take steps to manage their cash flows by offering terms for prompt payment, tightening credit policies, stepping up collection efforts, and monitoring their accounts receivables through aging of their accounts receivables (Coyle 2000; Dennis, 2001). Management accounting information can be useful with respect to many of these actions.

Management accounting information is both financial and nonfinancial information that is future oriented and provides assistance to managers in making decisions (Garrison, Noreen and Brewer, 2010; Horngren, Datar, Foster, Rajan, and Ittner, 2009). Management accounting information is used in planning and control. Planning involves selecting a measure of performance (e.g., net income) and selecting a goal or a target (e.g., budgeted net income) for its value over some future time period (Garrison et al., 2010; Horngren et al, 2009). Control involves taking steps to insure that the target is achieved (Garrison et al., 2010; Horngren et al, 2009). These steps involve monitoring and then evaluating actual performance of the specific measure to the target value of the measure (Anthony and Govindarajan, 2006). If the actual performance on the measure is not tracking in the right direction, then either intervening or changing the level of the target would be pursued (Anthony and Govindarajan, 2006). At the end of the period, a comparison of actual to target levels of the performance measure is made and the feedback is used in the next cycle of planning (Anthony and Govindarajan, 2006).

Most of the research on the use of accounting in business has been focused on large firms. There is little evidence on how small business owners use accounting information in general to manage the business and virtually none on the use of management accounting information. Management accounting information is intended for managers whereas financial accounting information (e.g., the income statement) is intended for external users such as bankers, investors, and so on. Financial accounting information does not provide decision support for small business owners in the form of forward looking, detailed, and economically relevant information (e.g., product costs, budgeted materials, breakeven, etc.). This type of information is necessary to run a business effectively.

Two studies are known to have examined the use of financial accounting information. Holmes and Des Nichols (1988) found that the annual use of profit and loss statements, balance sheet, and cash flow statements is positively associated with demographics of business size and age, industry, and level of education of the owner/manager. McMahon (2001) found that comprehensive financial reporting (e.g., use of profit and loss statements, balance sheet, cash flow statements) was positively associated with sales growth and higher annual sales revenue. However, neither of these studies examined the use of management accounting information (e.g., budgets, monitoring accounts receivable, etc.) in the management of small businesses.
QuickBooks®

QuickBooks® is an accounting software program that is widely used by small businesses. It captures 73% of the retail market (Business Week, 2005). The software program has many features that are potentially useful for small businesses in applying management accounting concepts to assist in managing the business.

QuickBooks® allows convenient and low cost recording of transactions involving purchases and sales, and payments and collections which are necessary inputs in terms of record keeping to provide the data for management accounting information. QuickBooks® has report features that allow a small business to easily create reports summarizing the effects of their transactions on company financials, customers and receivables, purchases, and vendors and payables. QuickBooks® allows planning and control to be implemented in the form of creating budgets, setting targets, computing breakeven, comparing actual to budgeted.

Despite the widespread application of QuickBooks® in small businesses, little or no empirical evidence is available on either its use and or its effects. Several studies have examined the choice of examined the choice of accounting software (Bressler and Bressler, 2006; Davis and Dunn, 2005). Bressler and Bressler (2006) reported that the highest ranked reason for selection was recommendation by a business counselor. In a similar vein, Davis and Dunn (2005) reported advice from a CPA as the highest ranked reason for accounting software selection. Between 54% (Bressler and Bressler, 2006) and 89% (Davis and Dunn, 2005) of users in these studies reported high levels of satisfaction with their software. However, there is no empirical evidence available on the use of QuickBooks® in the management of small businesses.

QuickBooks® can be used by small businesses to manage their cash flows. An important element of cash flow management is managing accounts receivable and collections. Businesses that have difficulty in collections will have higher balances of accounts receivable. The report feature of QuickBooks® provides reports on the aging of accounts receivables, transactions by customers, and customer balances which can be used the manage collections and thus accounts receivables. Frequent use of these types of reports allows a small business owner to monitor and get timely feedback on the size and age of accounts receivables.

Hypothesis

Frequent use of management accounting information enables a small business owner to respond more quickly to potential problems and thus to maintain a lower balance in the business's accounts receivable. QuickBooks® offers small business owners a way to regularly monitor accounts receivable data. Therefore, it can be expected that a business that monitors accounts receivable through more frequent use of QuickBooks® reports would have a lower accounts receivable balance.

H1: Small businesses that use QuickBooks® reports on accounts receivable more frequently will have lower accounts receivable balances than small businesses that use QuickBooks® reports on accounts receivable less frequently.

## Methods

*Sample*

The sample for this research was provided by a statewide Small Business Development Center (SBDC) of a New England state. The SBDC compiled a list of its clients who had been recent attendees at the SBDC's QuickBooks® training classes. In order to maintain the confidentiality of SBDC clients as well as their questionnaire responses, SBDC staff affixed labels, physically mailed the survey packets, and collected the completed questionnaires for the researchers. Respondents were assured of the confidentiality of their responses. The questionnaire itself had no identifying information. Four hundred and sixty-one surveys were mailed to small business owners in a timed series of mailings using the Dillman methodology (2004). This consisted of a pre-letter, a survey questionnaire, a postcard reminder, and then a replacement survey. Two raffle drawings were used to provide incentives for respondents to complete the survey. One hundred and twenty eight surveys were returned, yielding a response rate of 28%.

The small businesses in the sample have a mean of $294,403 in annual sales. Many of these businesses are microbusinesses, with over a third (38%) reporting no employees other than themselves. Forty-six percent have between 2 and 5 employees, 7% have 6 to 10, 7 % have 11 to 15, and only 3% have 16 to 30 employees. QuickBooks® has been used by the sample companies an average of five and one-half years. The mean age of sample respondents is between 46 and 55 years old. Almost three quarters of respondents are female (73%) and 27% are male.

Nearly half (44.6%) of the sample businesses are service businesses, 12% are retail businesses, 11% are construction businesses, 10% are manufacturing businesses, and 4 % are wholesale businesses. Eight percent of respondents indicated that their businesses are combinations of these types (e..g, retail and service) and another 13% indicated that their businesses are "other"
Measures

The independent variable was "Use of QuickBooks® Reports on Accounts Receivable". Three measures were used to operationalize the independent variable, "Use of QuickBooks® Reports on Accounts Receivable". The three measures were based on the reports available in QuickBooks® that show the accounting information system's representation of accounts receivable transactions. The first measure, Aging of Accounts Receivables Report, is the QuickBooks® report that shows the age of accounts receivables across all customers. For example, it includes categories such as zero to thirty days, thirty-one to sixty days, etc. The second measure, Customer Balance Report, is the QuickBooks® report showing the balances of customers. Customer Balance Report indicates any outstanding balances by individual customer, shedding insight to the aggregated Aging of Accounts Receivable balance. The third measure, Customer Transactions Report, is the QuickBooks® report showing a summary of transactions by each customer; this report would indicate credit transactions that similarly would shed insight to the aggregate Aging of Accounts Receivable Report.

The frequency of small business owners' use of each of the three reports was measured on a seven point Likert-type scale, ranging from Never to Daily. The item stem was, "How frequently do you use the following reports that are listed under the menu heading "Customer and Receivables"?

The dependent variable, "Accounts Receivable Balance", was assessed by the accounts receivable to sales ratio. Information from two questionnaire items was used to calculate the measure. Because of the sensitivity associated with asking for company financial information in survey research, an item response format using dollar ranges rather than finite amounts was employed to increase the likelihood that survey respondents would answer these questions. First, respondents were asked to indicate the range of their average accounts receivable balance over the last fiscal year. The ranges covered $10,000 increments from $0 up to $100,000. The increment of the range then switched to $50,000 increments from $100,000 to $1,000,000. Second, the measure of sales revenue was from a question asking respondents to indicate their total sales revenue over the last fiscal year. It likewise used ranges to gather responses: from $0 to $1,000,000 in increments of $50,000; from $1,000,000 to $5,000,000 in increments of $100,000. Finally, "Accounts Receivable Balance" was calculated by dividing average accounts receivable balance by sales revenue, yielding an accounts receivable to sales ratio.

*Analysis*

Multiple regression analysis was used to test the hypothesis, using the three measures (i.e., Aging of Accounts Receivables Report, Customer Transactions Report, and Customer Balance Report) of the independent variable, "Use of QuickBooks® Reports on Accounts Receivable", to predict the level of the "Accounts Receivable Balance", the dependent variable.

## Results

Descriptive statistics for the measures of the independent and dependent variables are shown in Table 1.

Table 1: Descriptive Statistics for the Dependent and Independent Variables

| Variable | Range | Mean | Median | Deviation |
|---|---|---|---|---|
| Aging of AR Report | 1.00 - 7.00 | 2.73 | 2.00 | 2.07 |
| Customer Balance Report | 1.00 - 7.00 | 3.04 | 3.00 | 2.07 |
| Customer Transactions Report | 1.00 - 7.00 | 3.21 | 3.00 | 2.14 |
| Accounts Receivable | 0.00 - 1.00 | 0.30 | 0.20 | 0.33 |

The hypothesis was supported by the multiple regression analysis. The results of the multiple regression analysis are shown in Table 2.

Table 2: Multiple Regression Analysis

| Variable | Regression Coefficient | t for coefficient | F for Equation | Adj $R^2$ |
|---|---|---|---|---|
| Aging of AR Report | -0.46 | -2.30** | 2.71** | .07 |
| Customer Balance Report | 0.58 | 2.72** | | |
| Customer Transactions Report | -0.19 | -1.39 | | |

The multiple regression model was significant at .05 with an Adjusted $R^2$ of .07, showing that the independent variable "Use of QuickBooks® Reports on Accounts Receivable" is a predictor of "Accounts Receivable Balance". Aging of Accounts Receivables Report was significantly and negatively associated with the dependent variable, "Accounts Receivable Balance" ($t=-2.30$ $p < .05$). Customer Balance Report was significantly and positively associated with the dependent variable, "Accounts Receivable Balance" ($t=2.72$, $p<.01$). Customer Transactions Report was not significantly associated with the dependent variable, "Accounts Receivable Balance".

## Discussion and Implications

This study provides the first known empirical evidence on the use of QuickBooks® software by small businesses for an important business management function, the management of accounts receivable. Results show the extent to which the small business owner respondents use available QuickBooks® management accounting reports related to accounts receivable as well as the benefits associated with the use of QuickBooks® for this purpose.

The findings of this research suggest that many small business owners, especially those with fewer than 30 employees, are making relatively infrequent use of QuickBooks® for managing their accounts receivable. As shown on Table 1, the highest use of an accounts receivable report was the Customer Transaction Report with a mean of only 3.21 on a seven point scale. Small business owners reported even less frequent use of the Customer Balance Report (mean=3.04) and the Aging of Accounts Receivable Report (mean=2.73). In fact, the modal response for all three types of reports was 1 on the seven point scale, suggesting that the surprising preponderance of these small business owners, nearly half (49.3 %), never make use of these reports at all.

At the same time, the results of this study demonstrate that those small business owners that do make use of the QuickBooks® reports on accounts receivables reap the benefits of lower accounts receivables balances. The hypothesis, "Small businesses that use QuickBooks® reports on accounts receivable more frequently will have lower accounts receivable balances than small businesses that use QuickBooks® reports on accounts receivable less frequently", was supported by the data. Specifically, use of the Aging of Accounts Receivables Report explained the greatest amount of variance in the dependent variable in the predicted direction, suggesting its centrality to the effective management of accounts receivable.

## Implications for Practice

This study has important implications for small business owners and small business counselors. Support for the hypothesis suggests that small business owners who now use QuickBooks® management accounting reports infrequently or not at all would benefit by stepping up their use of these reports. More frequent use is likely to lead to decreases in the balance of accounts receivable, offering a tangible advantage to the business by improving its collections and resulting cash flow. By making use of these easily generated, automated reports from QuickBooks®, a small business owner can quickly grasp the level and locus of accounts receivable and take action with specific customers to collect monies owed. Given the importance of cash flow as a common problem for small businesses, the QuickBooks® reports may prove invaluable as a practical managerial diagnostic tool.

The findings of this study also have implications for those who counsel small businesses. They suggest that counselors might improve service to their clients by encouraging the application of QuickBooks® for uses beyond financial reports, such as the accounts receivable reports examined in this study. Many small business clients, such as those who responded to this research, may attend basic classes in how to use QuickBooks® software. Development of follow-up training that addresses not just how to use QuickBooks® but the benefits of its use for management accounting purposes also would benefit clients. Since most clients use QuickBooks® anyway, its uses for managing the business should be accelerated.

n summary, this study addressed a gap in the literature by examining the use of QuickBooks® for management of accounts receivable in small businesses. The results have important implications for both small business owners and small business counselors, suggesting that an increased use of QuickBooks® reports has bottom line benefits for small businesses.

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# SUSTAINABLE ENTREPRENEURSHIP EDUCATION: A COMPARATIVE APPROACH

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## Abstract

Entrepreneurship programs have flourished at the university level over the last three decades. Two educational programs in entrepreneurship are presented. The first was developed without a solid base in strategic management principles, hastily put together to take advantage of market timing due to the widespread popularity of such programs. This program is compared to another program with decided competitive advantages developed through the bundling of valuable and rare resources and capabilities advocated by strategic management scholars as necessary for long term success.

## Introduction

Entrepreneurship programs have flourished at the university level over the last three decades. Although the first course in entrepreneurship, introduced at Harvard in 1945, was eventually dropped by the professor in favor of a focus on boards of directors (Vesper and Gartner, 1997), from the 1970s until today academic programs in entrepreneurship have grown considerably (Katz, 2003; Solomon, Duffy, and Tarabishy, 2002). Honig (2004) noted that over 1400 colleges accredited by the Association to Advance Collegiate Schools of Business (AACSB) offered courses in entrepreneurship, with 78 of the top 100 universities as ranked by U.S. News and World Report in 2004 offering courses in either small business management or entrepreneurship.

While university professors teaching entrepreneurship courses and directing academic entrepreneurship programs have a variety of backgrounds, both educational and practical, this paper will approach comparative entrepreneurship education from a strategic management perspective. The field of strategic management has developed from early twentieth century microeconomic theories to the current emphasis on the resource-based view of the firm (Barney and Hesterly, 2008; Priem and Butler, 2001; Ray, Barney, and Muhanna, 2004), a perspective that is coupled with the external environmental analysis tools of the industrial organization economics literature (Porter, 1981). What began as an attempt to understand competition has evolved into an exploration of what it takes to achieve firm sustainability, from both market and environmental perspectives (Cohen and Winn, 2007; Dean and McMullen, 2007; Lester, 2008; Parnell, 2008; Stead and Stead, 2004).

Two educational programs in entrepreneurship are presented. The first was developed without a solid base in strategic management principles, hastily put together to take advantage of market timing due to the widespread popularity of such programs. This program is compared to another program with decided competitive advantages developed through the bundling of valuable and rare resources and capabilities advocated by strategic management scholars (Barney, 1991; Dierickx and Cool, 1989; Rumelt, 1984; Wernerfelt, 1984) as necessary for long-term success.

This paper reviews the theories of competition from the early microeconomic proponents to the present strategic management theorists, with a particular focus on sustainable strategic management (SSM), perceived to be the key to long-term survival and success. A discussion of the current state of entrepreneurship programs at the collegiate level follows. Finally, some thoughts on establishing sustainable entrepreneurship educational programs are presented.

## The Field of Strategic Management

The field of strategic management traces its origin to three influential microeconomic theories, industrial organization (IO) economics (Mason, 1939), Chamberlinian economics (Chamberlin, 1933), and Schumpeterian economics (Schumpeter, 1934). While the focus of this paper is the stream that emerged from Chamberlinian economics, the other two streams will be briefly examined.

IO economics is an external, primarily deterministic model of competitive analysis. According to Mason and early proponents (Bain, 1956), returns are based on the structure of the industry a firm has chosen (Seth and Thomas, 1994). Attractive industries are characterized by high barriers to entry, few firms, abundant product differentiation, and low demand elasticity. The goal of all firms, earning above average returns, suggests creating or modifying the structural characteristics of the industry (Porter, 1980).

Chamberlin (1933) proposed a microeconomic theory of competition which has its point of origin in the firm, focusing on resources and capabilities. Industry structure is more easily altered if the firm is able to bundle its better assets and capabilities. This heterogeneous view of the firm says that competitive advantage (Barney, 1985) can be attained by exploiting superior technical knowledge, reputation, brand awareness, and management cooperation (Chamberlin, 1933). Rather than a dominant focus on finding favorable industries, the exercise of strategic choice (Child, 1972) allows a firm to build on its internal individuality, or differentiate from competitors. Chamberlin starts from a different perspective, but he does not contradict the IO model. Rather, he accepts it and builds on it. Likewise, the IO economists do not deny the heterogeneous nature of competitive firms, acknowledging the existence of product differentiation (Bain, 1968) within industries.

The third microeconomic theory derives from the work of Schumpeter (1934). While IO and Chamberlinian theories concentrated on the ongoing competitive activities of firms, Schumpeter (1950) focused on the period of seismic shift or revolution in industries. Following a period of stable industry competitiveness, Schumpeter (1950) identified innovative activity, such as product, market or technology innovations, that dramatically altered the structure of the industry, forcing competitors to adopt the new innovation or be destroyed by it. He termed this phenomenon *creative destruction*.

The culmination of previous microeconomic and strategic management research is the current focus on the resource-based view. The resource-based view (RBV) of the firm has intensified the movement from the industry level of analysis to the firm level. The term resource-based view was introduced to the literature by Wernerfelt (1984). Several noted management researchers have made vital contributions to the theory, including Rumelt (1984), Barney (1991), and Dierickx and Cool (1989). Simply stated, RBV predicts that firms can generate competitive advantage and earn above-average returns through the implementation of valuable, inelastic resources (Barney, 1986; Ray, Barney, and Muhanna, 2004), and earning above-average returns is a key to sustainability.

The primary thrust of the RBV is that firms have resources, capabilities, and competencies (Barney, 1991). Resources, which can be tangible or intangible, and capabilities can lead to a sustainable competitive advantage when they meet a four-part test. They must be rare, valuable, costly to imitate, and nonsubstitutable. Resources are considered rare when they are uncommon

relative to other competitors. They are valuable when they lead to conditions of internal efficiency or effectiveness. As for being costly to imitate, or inimitable, resources that meet this condition are critical if a firm is trying to create value and outperform competition. Inimitability can be achieved in several ways. The first is through physical uniqueness, such as owning mineral rights or having a prime vacation location. The second is path dependency where resources become unique via the complicated path they took to be accumulated or developed. The third source of inimitability is through causal ambiguity, meaning that the source of a resource is impossible to pinpoint. And, fourth, if a resource is due to a high degree of social complexity it is difficult to imitate. The last condition of nonsubstitutability refers to the availability of substitutes, resources that serve as strategic equivalents.

The key to earning above average returns and achieving long-term sustainability is the process of bundling these unique resources and capabilities to produce a competitive advantage in a firm's product market. Critical to retaining this advantage over competitors could be continuous innovation in products or processes (Barney and Hesterly, 2008). Barney defines this competitive advantage as being able to achieve more economic value than one's rivals, with economic value referring to the difference between perceived benefits realized by customers when compared to costs (Barney, 1991). RBV also recognizes the importance of scanning, monitoring, assessing and forecasting a firm's external environment as demonstrated by the IO economists.

## Sustainable Strategic Management

While the resource-based view has long promoted sustainability as one of its hallmarks, a relatively new direction has emerged that builds on RBV with a somewhat expanded outlook on sustainability. Looking beyond competitive advantage (Barney, 1991), researchers have begun to focus on a broader definition that includes the environment (Cohen and Winn, 2007; Dean and McMullen, 2007; Parnell, 2008). Sustainability has been simply defined as the ability to "meet the needs of the present without compromising the ability of future generations to meet their own needs" (World, 1987). This emphasis has led to a two-factor approach to sustainability that includes both market and environmental success.

Market sustainability is consistent with the notion of the RBV of sustainable competitive advantage (Barney, 1991). Environmental sustainability can include issues such as the natural environment of a firm's operations (Stead and Stead, 2004), political-legal issues relative to the firm and its industry, and even crisis management. Thus, a working definition of this new thrust toward a more comprehensive framework on sustainability is as follows:

> *Sustainable strategic management refers to the strategies and related processes associated with the continuity of superior performance—broadly defined—from both market and environmental perspectives.* (Parnell, 2008)

Therefore, sustainable strategic management, as a subdiscipline of strategy, is noteworthy in two ways. First, sustainable strategic management requires an interdisciplinary approach. Market competitiveness must be combined with an environmental approach. This clearly relates the discipline of strategic management to other diverse fields, including biology, economics, public administration, and the law (Parnell, 2008).

The second important facet of sustainable strategic management is that businesses must confront the inevitable fact that what is best for profits is not always best for society. This is a particularly difficult notion where free markets are concerned, but it underscores the fact that market sustainability is short-lived without environmental sustainability.

A foundation for this new perspective can be traced to Schumpeter's notion of creative destruction. Schumpeter's (1934) process of creative destruction inevitably relies on an entrepreneur to bring an invention to market as an innovation. If this innovation is radical enough, competitors must change their technology to meet the new challenge or eventually go out of business. Thus, the industry is structurally altered until the next new dramatic innovation is introduced.

## Entrepreneurship Education

While it was noted earlier that many higher education institutions around the world offer courses in entrepreneurship (Katz, 2003) and/or small business management, the focus of this article is academic *programs* in entrepreneurship. The number of entrepreneurship programs is much smaller than the number of schools offering one or more courses (Solomon et al, 2002; Vesper and Gartner, 1999). Yet a consensus does not prevail as to what constitutes a program of high quality (Vesper and Gartner, 1997).

Kuratko (2005) defined entrepreneurship as a process that starts with opportunity search, involves greater than normal risk, and requires the tenacity to push an idea through to reality. Although there are some similarities between traditional management education and that of entrepreneurship, the former has been conceptualized as resource-driven and the latter as opportunity-driven (DeTienne and Chandler, 2004; Ireland, Hitt, and Sirmon, 2003). Yet, entrepreneurship education quite naturally involves a good deal of management education (Miles and Covin, 2002; Kuratko, Ireland, Covin, and Hornsby, 2005), and others are calling for more entrepreneurship emphasis in traditional management programs (Parnell and Lester, 2007).

Entrepreneurship education generally embodies a sequence from idea generation, to business planning, to capital resource acquisition, to start-up, and the management of a small business (Parnell and Lester, 2007). Most schools start with a business core of courses that would be a requirement of any business major and pair it with a select group of courses in entrepreneurship and related subjects. This was noted by Vesper and Gartner (1997) in their study of entrepreneurship programs where a search of course catalogs revealed the following courses to have been offered the most: entrepreneurship, small business management, field projects/venture consulting, starting and running a firm, venture plan writing, and venture finance. In a seminal work, Solomon, Duffy, and Tarabishy (2002) pared the needs list for entrepreneurship educational programs down to three essentials: opportunity identification, marshalling of resources, and venture creation.

Despite the growth in the number of programs and students, criticism of entrepreneurship education has been widespread (DeTienne and Chandler, 2004; Honig, 2004; Jack and Anderson, 1999; Livesay, 1982). Much of the criticism revolves around the notion of whether entrepreneurship is an art or a science. While this debate aptly applies to other disciplines such as strategy (Parnell and Lester, 2003) and management, it seems to be particularly appropriate as

it relates to entrepreneurship. As Johannisson (1992) noted, entrepreneurship is not based on positive knowledge and it is soft and personal as opposed to hard and empirical. Are not the best entrepreneurs those that see the world in a different way (Jack and Anderson, 1999)? Hofer and Bygrave (1992) presented entrepreneurship as holistic, dynamic, unique and sensitive to a number of antecedent variables. Jack and Anderson (1999) described the entrepreneurial event as an enigma, unique and idiosyncratic.

Another issue of concern regarding current entrepreneurship education is the overemphasis by many schools on business planning (Bhide, 2000; Honig, 2004; Stone and Brush, 1996). Perhaps because of the influence of strategic management (Armstrong, 1982) or the perceived value of having to work through the various categories required by the business planning process, or the very convenient output that assists in student evaluation (Honig, 2004), entrepreneurship instructors rely heavily on this nearly semester-long activity. Several researchers have questioned the value of the time spent in entrepreneurship courses on business planning (Gumpert, 2004; Honig, 2004; Honig and Karlsson, 2004), and empirical results relating planning to success have been mixed (Boyd, 1991; Bracker, Keats, and Pearson, 1998; Robinson and Pearce, 1984).

Gumpert (2002) has suggested that business plans are prepared too early in the overall process, they are rarely updated after initial preparation, and they typically overestimate the potential value of the business they are planning. With everyone using standardized templates or software, Gumpert (2002) argued that investors in particular are not getting what they need from business plans. The approach recommended by Gumpert (2002) is the preparation of a brief synopsis, a strong verbal presentation, a web site detailing the business, and some basic financials.

Some of the most outspoken critics of academic entrepreneurship programs are actually successful entrepreneurs. In 2006 *Fortune* solicited opinions from several high-profile business founders, such as Ann Winblad of Hummer Winblad Venture Partners, Doris Christopher the founder of Pampered Chef, Paul Fleming who founded P.F. Chang's China Bistro, and David Neeleman of JetBlue (Gray, 2006), regarding entrepreneurship education. Each entrepreneur was critical of the academic world's approach to teaching entrepreneurship. While there was some recognition that education could be valuable, the consensus was that nothing was better than practical experience, and as Ann Winblad related, it is very hard for a university to teach you that entrepreneurship is about having guts. Yet several students were featured in the Fortune article proposing just the opposite perspective. They believed that exposure to entrepreneurship through their respective universities and the valuable connections to the business community that were an integral part of their programs had given them the confidence to open businesses while still pursuing degrees (Gray, 2006).

The emphasis on experience is reinforced by David Birch, an academic and first recipient of the International Award for Entrepreneurship and Small Business Research, who believes that encouraging entrepreneurship should be accomplished through apprenticeship (Aronsson, 2004). Birch (1979) was one of the first to reveal that new jobs in the economy are usually generated by small firms guided by entrepreneurs. This notion is supported by empirical research (Kuratko and Hodgetts, 2004).

## Designing an Entrepreneurship Academic Program

There is no one specific framework that guarantees success for an academic program in entrepreneurship. However, there are some general guidelines that emanate from the literature and thirty years of experience the academic world has in teaching the courses. Plaschka and Welch (1990) put forth four separate dimensions for categorization of entrepreneurship education nearly two decades ago, including number of courses offered, the degree of integration, stages of business transition from start-up to maturity, and the number of disciplines involved in the program. This emphasis on integration has been echoed by others as it suggests that programs could be beneficial to students in all majors, not just business. Solomon, Duffy, and Tarabishy (2002), as previously noted, suggests entrepreneurship educational programs require three essentials: opportunity identification, marshalling of resources, and venture creation.

In keeping with the resource based view of strategy, a new enterprise such as an academic program in entrepreneurship needs rare, valuable, inimitable, and nonsubstitutable resources and capabilities that produce perceived value to students. One primary resource is the teaching faculty. Since academic credentials are essential to accreditation, they are important. For example, unlike thirty years ago, several universities now offer terminal degrees in entrepreneurship. While many entrepreneurship faculty are rooted in the strategic management or marketing tradition, those newly minted from terminal entrepreneurship programs bring a fresh approach and understanding to the current research focuses in the field. As long as entrepreneurship programs are housed in colleges of business, terminal degrees from accredited business schools are essential.

Many also advocate that past experience owning and operating a business is a critical component of an entrepreneurship faculty (Bennis and O'Toole, 2005). When a faculty member has been through a start-up and launch of a new business, an inimitable capability results from the social complexity this type of experience creates. No two business experiences are identical, and professors who have fought the daily struggle to build and grow a small business at least understand the 'guts' and experience factors referred to above (Gray, 2006). It might be an unreasonable goal for an entire entrepreneurship faculty of a large university to have both terminal degrees and past entrepreneurial experience. It should be noted, however, that a study of criteria important to entrepreneurship program ranking, as ranked by academics, listed faculty experience with business start-ups next to last (Vesper and Gartner, 1997).

Another important resource is money. Without a base of capital, new programs must rely on word-of- mouth advertising to grow and achieve critical mass. Capital enables program managers to recruit outstanding students and promote the program in the local community, provides travel funds for benchmarking already established successful programs at other universities, and contributes to the recruitment of at least an above-average faculty.

One other important advantage that will set a program apart is the ability to successfully integrate the program across the campus with other programs and departments. This integration should go beyond merely offering a minor in entrepreneurship for students majoring in other areas. Joint programs, classes designed specifically for certain majors, such as Jack and Anderson's (1999) class for physicians, and faculty from other departments who can contribute to the richness of the program due to their past experience or expertise, are all valuable components.

A final but important component of any entrepreneurship education program is an opportunity for students to receive some practical experience. According to Peterman and Kennedy (2003), programs that emphasize practical application through experience tend to promote entrepreneurial intentionality.

## Research Methodology

The purpose of this article is to compare the establishment of one entrepreneurship program at a regional, comprehensive public university in the United States with a total enrollment of over 20,000 (Program A) with that of another program at a regional, comprehensive U.S. public university with a total enrollment of just over 15,000 (Program B). Several criteria were employed in the selection of each program. Schools were chosen because of similar size (10 – 20,000 students), and similar type (both state supported, comprehensive universities), because each had an entrepreneurship program as opposed to a few course offerings, one program had to be on every published list of best programs in the United States and the other not on any list, and the authors had to have some personal familiarity with each program.

A review of secondary data published over a period of several years (*Entrepreneur/Princeton Review*, 2007; *Fortune Small Business*, 2007; *U.S. News & World Report*, 2000) revealed several viable schools. School websites were visited, entrepreneurship professors were interviewed, and academic journal articles that compared or ranked entrepreneurship programs were read (Solomon, Duffy, and Tarabishy, 2002; Vesper and Gartner, 1997). The final determining factor was the authors' familiarity with two programs that met all of the criteria.

## A Nonsustainable Approach

*Program A*

Program A was started within the College of Business (COB) in the late 1990s. The idea began in a department that taught business education and business communication, originating specifically from the business education side of the department. This department had taught an entrepreneurship course as part of their curriculum to train future high school business and entrepreneurship teachers. A well respected faculty member in this department attained a grant to further the process of entrepreneurship education, and the grant was applied toward starting an entrepreneurship minor, potentially to be followed by an entrepreneurship major a few years later. The existing faculty in this department was trained in education and communication, not entrepreneurship nor management. However, there were resource issues that led the department to pursue development of this program. Within the COB, the department's share of students majoring in their areas was diminishing. This meant, at best, the potential for reduced resources from the COB, and at worst, the possibility that the department might be eliminated if it did not find a way to increase its student count. An entrepreneurship program, a very popular course of study and one not offered by other public colleges in the geographic market, seemed a viable method to ensure the resources necessary for the survival of the department.

Given the department's lack of trained faculty in the area, and the fact that the Management department at that time offered a Small Business Management course, the COB Dean suggested a joint development effort between the departments. Unfortunately, the Small Business Management course was being staffed by adjunct faculty, so the Management department also was weak in offering resources to the program. A junior faculty member with entrepreneurial interests was placed on the committee with two senior faculty members from the education department to create the entrepreneurship program for the COB. The senior faculty members

had knowledge of the inner workings of the university concerning program development, a valuable resource for seeing the program through the bureaucracy. The junior member had knowledge of management and entrepreneurship theory and practice, valuable for building a strong program, but no experience in program development and no leverage to negotiate with the senior committee members. Ultimately it became clear that both sides were tasked with looking out for the interests of their respective departments.

The process began with the development of a minor, primarily because it was perceived to be politically expedient since minors did not require state regent approval. The model for existing minors in the COB was followed. Per those examples, existing courses were used to fill the requirements for the minor; no new courses were developed. The same Entrepreneurship course that had been used to train potential high school business teachers and the same Small Business Management class that was used as a management elective were to be used for training students to start their own businesses. It is suggested here that these were not the type of resources sufficient to found a successful program.

The subsequent development of the major, again driven by a perception that the timing was politically advantageous, offered only slightly more hope to the program. The junior faculty member researched existing entrepreneurship programs at universities worldwide. To expedite program development, the committee chose to imitate the model of a particular well-respected U.S. university. The model allowed the program to be built around the existing resources of the Entrepreneurship and Small Business Management classes. Two additional classes were developed to fit the model chosen, with one developed in the education department and the other in the management department. This allowed both departments to be equally represented in the major. However, the classes were not developed to take advantage of existing faculty strengths/knowledge, but rather to fit the template of the favored model.

The program has been operating for several years, and while it is still jointly held, there is very little communication or cooperation, which causes issues at the operating level. The education department hires new faculty into the program who do not possess business degrees. The management department does not have the necessary student count in its two classes to hire more than the two existing entrepreneurship faculty, and these faculty members already teach classes outside the entrepreneurship program, thus diluting the resource commitment to the entrepreneurship. Students complain of overlap between the courses offered in the major, but joint department meetings to discuss duplication, or any other issue, are rare and unproductive. Changes are resisted, most likely due to each department's concern that they may lose COB resources if needed changes are made to the program. Each department also offers its own student entrepreneurship group rather than pooling resources to develop one strong group.

In summary, this program was developed as a reactionary measure to attract valuable resources and to ensure the resource flow to a COB department. It was developed in the absence of rare or valuable resources that would be necessary for the success of the program. As a result, it achieved strong student numbers early, but enrollment has since declined. It has not earned a reputation for program quality that would be an assumed goal for such an endeavor. The program continues to struggle to attract the type of resources that will be necessary to bring it to a successful level, such as external supplemental funding, entrepreneurially successful graduates, or local business partnerships.

*Program B*

Program B originated in the department of management at a regional state university approximately twenty years ago. While its beginnings were not dramatically different than that of Program A, several foundational differences are worth noting. First, Program B promoted integration across its campus for the entrepreneurship program. From early on in the process of developing its curriculum an overall programmatic approach was taken. Faculty from all disciplines were encouraged to participate in the development process, and several sound ideas from within and without the COB were incorporated into the planning process. Second, the faculty in the management department of the university promoted the program to the local business community from the outset. Strong ties to the department and the program resulted from this effort which was to pay strong dividends in the future. And, third, resources to fund a chair of excellence in entrepreneurship were committed/raised within the first year of the program's launch, setting the program up for success.

Today, Program B is recognized by all relevant measures to be a top-rated undergraduate entrepreneurship educational experience. It has been recognized by *U.S. News & World Report, Fortune Small Business Magazine, Entrepreneur Magazine, and the Princeton Review*. Its curriculum includes a consulting course where students participate in a small business research project with a local company, a human resource management class that emphasizes the critical need for adding valuable employees as new enterprises grow, a required semester of internship with a small business owner or in the business development department of a large business, and a course on innovation and creativity, certainly hallmarks of sustainable competitive advantage.

A national business plan competition is sponsored by the entrepreneurship Center that was developed and staffed a few years into the program. The Center is also involved in several other projects, including assisting the consulting course professor with securing local business participation and cooperation. Through the efforts of the Center's staff and director, close contact is maintained with graduates of the program. At last count, over 40% of all entrepreneurship graduates had either founded their own businesses or purchased an existing firm.

One final note regarding Program B involves faculty research. Because an entrepreneurship Chair of excellence was funded in the program's first year, research, both academic and practical, has been a defining capability of the program. While more than one Chair has served, the output of quality empirical research from the entire faculty teaching in the program has been noteworthy.

## Discussion

As Minniti has noted, 'entrepreneurs are individuals who deviate from the mean.' (2006; p. 30). If an entrepreneurship education program is to be successful fostering the kind of innovative and creative learning environment needed to nurture business leaders who deviate from the mean, the model of Program B is clearly more appropriate than that of Program A. While at first glance the program differences might seem minor, a more thorough review reveals they are actually stark. Program A, housed in two different departments but managed out of the one that has no academically-qualified faculty, has recently lost enrollment, fails to track any of its graduates (which might provide them with some valuable marketing opportunities), teaches business planning in three different required courses, produces little in the way of valuable empirical research for academic journals, has no business plan competition outside of an in-class exercise, and only involves the local business community for a day or two each year.

Program B, however, has maintained a consistent enrollment of competitive majors, regularly produces quality academic research, tracks its graduates (publicly promoting their successes), has a national business plan competition, and involves the local business community in projects and the classroom frequently. Program A has never been ranked in any entrepreneurship ranking publication, while Program B has been recognized as one of the best programs in the United States for many years.

Strategic sustainability requires the successful combination of two ingredients: market sustainability and environmental sustainability. For education programs in entrepreneurship, market sustainability is accomplished through the implementation of valuable resources backed by rare capabilities. The capabilities of Program B are the qualified faculty, both academically and practically, and the Center for entrepreneurship. When the program's resources are combined with the capabilities of the Center and the faculty, a distinctive competence (Lado, Boyd, and Wright, 1992) emerges that sets the program apart. As for Program A, a less-than qualified faculty combined with limited resources has produced what is predicted to be a nonsustainable program, devoid of competitive advantage. For Program B, environmental sustainability is evident first through the active involvement of the local and state-wide business community with the faculty and Center. Second, a required course on innovation and creativity emphasizes the importance of contributing to environmental sustainability as a necessity for long-term business survival. For Program A, the one or two days a year of local business community involvement, the lack of a dedicated Center, the huge void in the curriculum of any specific practical entrepreneurial experience, and the focus on business planning as opposed to creativity and innovation in new start-ups suggest the program may be nonsustainable.

In summary, entrepreneurship education programs vary greatly in their composition and perceived quality. While several methods of evaluation have been put forth, some consistent ingredients are universally recognized. An academically-qualified faculty, an integrative approach with other departments of the university, close contacts with the local business community, and an emphasis on innovation and creativity all contribute to attracting and maintaining a critical mass of students. Program B has mastered this approach, setting its program up for long-term success from the beginning. Program A seems to have been trying to preserve a department that was dying by creating a program that was recognized as attractive to students.

## Redesigning Entrepreneurship Education

It is time for entrepreneurship education to be reassessed through the pursuit of a new direction for the popular but somewhat dated attempt to educate future new venture creators (Cohen and Winn, 2005; Dean and McMullen, 2005). This paper has advocated a strategic management approach, specifically the RBV, as one lens from which to view the need for a long-term perspective of entrepreneurship education. While reviewing the past success strategies of programs will provide a backdrop for development, entrepreneurship as a field is all about the future. As Venkataraman (1997) has related "entrepreneurship as a scholarly field seeks to understand how opportunities to bring into existence "future" goods and services are discovered, created, and exploited, by whom, and with what consequences."

Taking this call a step further, Dean and McMullen (2007) have defined sustainable entrepreneurship as "the process of discovering, evaluating, and exploiting economic opportunities that are present in market failures which detract from sustainability, including those that are environmentally relevant." If entrepreneurship educational programs are to prepare university students for the future creation of successful enterprises, they need to promote sustainability as an outcome, not only of their students' entrepreneurial efforts but of their own academic programs. Promoting market and environmental sustainability to students may best be accomplished by ensuring the same of the academic program itself.

A brief summary of current thinking regarding where the field of entrepreneurship education should be headed is relevant to this effort to achieve sustainability. Reinforcing the RBV is Solomon, et al.'s (2002) notion that three approaches should underpin any program: opportunity identification, marshalling of resources, and venture creation. Opportunity identification may be the hallmark of that trio (Honig, 2004; Saks and Gaglio, 2002). While many professors believe it impossible to teach opportunity identification, there are theoretical underpinnings for this stream of pedagogy, including that of Fiet (2002) who advocates a systematic search for opportunities. Following that lead is the practical idea that failure is a key component of learning to succeed (Shepherd, 2004). Most successful entrepreneurs have noted failures in their past and clearly advocate failure as a great teacher (Gray, 2006). And, finally, consideration must be given to the enormous emphasis still being placed on traditional business planning, a dated and almost pretentious activity that programs cling to because they don't know what else to do.

In evaluating current programs, the RBV offers a simple, but effective, analytical tool. Think through the options available to educators and administrators, and choose resources that meet the RBV standard for sustainability. As previously indicated, most analysis should begin with the faculty and available capital resources. A simple model is presented below that provides an example of faculty as a resource.

Table 1: Framework for RBV Analysis

| Resource/Faculty | Valuable | Rare | Costly to Imitate | Nonsubstitutable |
|---|---|---|---|---|
| Not terminally-Degreed | No | No | No | No |
| Terminally-degreed; Not in business | Yes | No | No | No |
| Terminally-degreed; In business but no Entrepreneurship Experience | Yes | Yes | No | No |
| Terminally-degreed; In business and with Some entrepreneurship Experience | Yes | Yes | Yes | Yes |

As Table 1 denotes, only a terminally-degreed-in-business professor with practical entrepreneurial experience can provide an educational program with a valuable, rare, costly to imitate, and nonsubstitutable resource. The importance of this resource is what flows from it, including the potential for outstanding research, coursework that is not formulaic in relying solely on business planning or theory, a practical application to the classroom experience, and a resource that is more than likely already predisposed toward the local business community.

The lessons of Program A are clear. Jumping on a popular bandwagon like entrepreneurship education is no way to try to salvage an educational department that no longer seems viable. It leads to common, easily imitated resources that hold no future promise of excellence, and, over time, the program will wane, threatening the very existence of the department that it was created to save.

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# ENTREPRENEURIAL TEAM CHARACTERISTICS AND NETWORKING: IMPACT ON INNOVATIVENESS

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## Abstract

The survival of small busineses (SME) is dependent on the extent to which they can create competitive advantage through innovative activities. Innovativeness is a capacity that fosters adaptation through self-renewal. This paper highlights the influence of entrepreneurial team demographics and networking on innovativeness. As hypothesized, the findings suport the view that both entrepreneurial team characteristics (average age, age heterogeneity and average education) and networking (networking particularly with public organizations) play a significant role in innovativeness of SMEs after controlling the significant effect of team size. The implications of our findings on the policies of public organizations and educational institutions will be discussed.

## Literature Review

*Innovativeness Construct*

The resouce dependency theory of organizations emphasizes the importance of internal and external resources in company performance (Barney, 2001; Peteraf, 1993). Long-term survival of small business is crucial and this can be achieved through innovative endeavors of entrepreneurs (Desphande and Farley; 1999, 2000). In order to exploit an opportunity, entrepreneurs need to combine resources in a novel way that would enable them to survive. Organizational innovativeness is a means for change (Damanpour, 1991), yet differs from change with an intentionality of direct benefit and newness (West and Farr, 1990). An organization's overall innovativeness construct is defined as " introducing new products to the market, through combining trategic orientation with innovative behavior and process" Wang and Ahmed (2004). Innovativeness implies the propensity for a constant innovation and five interlinked areas have been identified by Wang and Ahmed (2004) which are product innovativeness, market innovativeness, process innovativeness, behavioral innovativeness and strategic innovativeness.

Organizations vary widely in their capacities to innovate (Cohen and Levinthal, 1990). The mode of innovativeness can be captured with the help of different resources. Human resources are already possessed by a small firm. Recent literature emphasize the importance of entrepreneurial teams whose trait combination/characteristics is a major asset for innovativeness. Entrepreneurial teams concept can be built on top management teams (TMT) research which had defined TMT as individuals that have power and authority to make strategic decisions. According to Brunninge et al, (2007) top management teams' involvement is more intense in small businesses due to their small size and flexible structure. Therefore, the capacity created by entrepreneurial teams is crucial in developing strategies yielding innovativeness. The knowledge and experience encapsulated in small firm's entrepreneurial teams can assist identifying use of new resources in a unique way. Human capital characteristics are important in helping entrepreneurial teams to greater opportunity sets.

*Entrepreneurial Team Demographics*

Since SMEs lack the size and financial resources that large firms have for use in innovative activities, there is a high reliance on what individuals know (Wicklund and Shephard, 2003). Pertaining to the role played by top management teams' characteristics to enhance innovativeness there is substantive research in large firms (Wiersema and Bantel, 1992; Canella et al., 2001; Camelo-Ordaz et al., 2004), however little is done to address the importance of this factor in SMEs. Since SMEs have less complex structure and strategy, less organizational inertia the entrepreneurial the human capital emerges as a critical factor (Davidson and Honig, 2003; Shrader and Siegel, 2007). Therefore, the salient entrepreneurial team demographics and the crucial role they play in determining innovative capacity is searched. Entrepreneurship literature recently cite the importance of entrepreneurial teams in determining the scope and success of strategic choices such as innovative activities. Demographics characteristics of entrepreneurial teams are indicators of their ability to access and use knowledge for innovation purposes.

Formal education level of managers has been accepted as an indicator of their cognitive abilities (Daellanbach et al, 1999) contributing to their performance involving innovativeness. In past research, positive relationship with top management teams' average education levels and their commitment to education were found. Gender heterogenity is one of those demographics which was found to influence quality of solutions (Maier, 1961), performance (Wood,1987), originality (Kent and McGrath, 1969). Similarly average age is found to have influence on innovativeness (Hambrick and Mason, 1984) whereby young managers were identified having the ability to spend more physical and mental effort to bring change (Child, 1974); possessing better knowledge (Bantel and Jackson, 1989) and taking more risks than older (Vroom and Pahl, 1971). Contradictory views exist with respect to the influence of age heterogeneity on innovativeness such as; age heternogeneity increases innovativeness as different age groups bring diverse attitudes, values and perspectives boosting creativity (Elder,1975) or different values lead to higher conflict obstructing decisions on strategic actions such as innovations (McNeil and Thompson, 1971; Pfeffer, 1983). Innovativeness is affected by experience of the entrepreneur (Honig, 2001). In detail tenure‘s effect of innovativeness led to contradictory research findings. Hayes and Abarnathy (1980) indicated that long time experience in a company accumulates leads to openness to innovative investments. Hambrick and Mason (1984) and more recently Daellanbach et al.(299) failed to find supporting views on the positive relationship between tenure and innovativeness. The implication of their finding is that long time working in a company leads to focus on current products and markets rather than new ones. The findings on the relationship between tenure heterogeneity and innovativeness shows mixed effects. From one perspective, tenure heterogeneity ads cognitive diversity. However, it can also increase conflict and create a barrier for innovativeness (Katz, 1982; Pfeffer, 1983; Bantel and Jackson, 1989).

The above research is used to develop the below hypothesis for our research:

Hypothesis 1: There is a positive relationship between gender heterogeneity of top management team and innovativeness.

Hypothesis 2: There is a positive relationship between age heterogeneity of top management team and innovativeness.

Hypothesis 3: There is a negative relationship between average age of top management team and innovativeness.

Hypothesi 4: There is a positive relationship between tenure of top management team and innovativeness.

Hypothesis 5: There is a positive relationship between tenure heterogeneity of top management team and innovativeness.

Hypothesis 6: There is a positive relationship between average education level of top management team and innovativeness.

*Networking*

While internal resources such as entrepreneurial team characteristics are critical to innovativeness, the connections with external knowledge sources complement the resouces that small businesses need. In support of this view, previous research concluded that top management team characteristics may not be enough to predict organizational outcomes, thus other predictor variables such as networking need to be added to the analysis (Carpenter , 2002). Networks are valuable for bringing innovation-specific resources and expertise for entrepreneurial teams to exploit (Rothwell, 1991; Zaheer and Bell, 2005). Hendry et al., (1995) cited firms' desire to obtain information and resources as primary explanations for networking. Likewise, knowledge opportunities is also identified as primary reason for engagement with networks (Brunetto and Far-Wharton, 2007).

Different theories provide evidence as to the importance of networking. Organizational learning theory explains innovativeness capacity with an inherent learning process. Small businesses exchange resources and information with external resources to incorporate skills, knowledge and behaviors to their sets of skills. Throughout innovation process learning needs of entrepreneurial teams are met by various external relationships that shape innovativeness capacity of the entrepreneurial team. Social capital theory also highlights the importance of relations whereby social capital creates a context for social interactions and facilitates the formation of new linkages (Tsai, 2000; Spence et al., 2003) to boost innovative activities.

Innovation does not happen in a vacuum dissociated from the rest of the world. In addition to their internal resources, small businesses have to build informal and formal netwroks to expand their existing resources (Autio et al., 1997). Stakeholders such as government agencies, universities, suppliers and competitors are those who have influence on innovativeness (Gibb,1995). The impact created vary depending on the type of linkages. Vertical linkages such as suppliers and cusomers influence cost reduction, risk-sharing opportunities, and timeliness. Horizontal linkages, on the oter hand, have complement know-how (Tidd et al., 1997).

The value of networking with customers is obataining feedback about product design and development which serves as an input in product/process innovation (Rothwell and Gardiner, 1985) and lengths product life span (Freel, 2000). In support of this view, Freel (2003) found positive relationship between relations with customers and new product innovations. Similarly, networking with suppliers enhance competitiveness (Ramcharran, 2001) wih an ultimate effect

on innovativeness capability (Dodgson, 1991). Although competitor is the most neglected stakeholder, collaboration revealed positive effect on innovativeness particularly in biotechnology industry (Baum et al., 2000; Su et al., 2009). Partnership with industry is on the agenda of many universities as part of national policies to strengthen innovativeness. Wilkinson et al. (1996) found that 90% of the most innovative firms they studied had formal links with universities. Additionally, a significant relationship was found between introduction of new products and university networking (Freel, 2003). The regulatory environment of public sector is at interface with small business growth and development.Collaboration with public organizations has a positive effect on innovations (Freel, 2003) and breeds the skills, attitudes and values of entrepreneurs (Gibb, 1995) needed for being innovative.

Hypothesis 7: Networking with stakeholders such as customers, universities, suppliers, public organizations and competitors have positive relations with innovativeness.

## Research Methodology and Results

*Sample*

The study was conducted in the largest Organized Industrial Site of Bursa, Turkey. SMEs are defined as the economic units that have less than 250 employees and less than 25 million TL net annual sales or financial statement (http://tr.wikipedia.org/wiki/KOBI). A total of 136 companies from different sectors were identified utilizing the websites of Bursa Organized Industrial Site and KOSGEB (Small and Medium Industry Development Organization). Contact information of the companies was gathered from the websites and companies were informed about study. Out of the total number contacted, 119 accepted to cooperate. The survey resulted with 77 returned questionnaires. Finally, 74 usable responses (response rate = 62.18%) remained after eliminating those that were filled either by manager without the team or included missing responses to many questions.

*Measures of Variables*

Innovativeness scale used was developed by Wang and Ahmed (2004) which contained 20 items. One item was eliminated since it was not appropriate for the purpose of the research. Networking scale was developed by Freel (2003). Six- point Likert scale ranging from 1- strongly disagree, 2- disagree, 3- slightly disagree, 4- slightly agree, 5- agree and 6- strongly agree was used to rate the items. The Cronbach's α for the innovativeness scale ($\alpha = 0.895$) is acceptable according to Nunnally (1978). Networking activities were measured by asking 5 separate questions (Freel, 2003). Networking with customers, suppliers, competitors, universities and public agencies (such as EU, TUBITAK, KOSGEB, government offices, other support agencies, etc.) for innovation-related activities were determined by forming binary dummy variables. Those who networked with a party for innovation related activities during the last three years were coded as 1; otherwise they were coded as 0.

The entrepreneurial team data is collected by asking first the number of people in the founding team and current management team and the current entrepreneurial team size. Following these, a) gender; b) current age; c) education level attained; d) occupation; e) tenure in the company and f) total tenure related data were asked. For education question, six categories were provided as elementary school, high school, two-year degree, college degree, masters' degree and

doctorate degree. However, for the analyses, these categories were turned into continuous variables by recoding the members that have elementary education as 8 years, high school education as 11 years, two year degree as 13 years, college degree as 16 years, masters' degree as 18 years and doctorate degree as 22 years.

Team variables that were used in the analyses such as average age, average organizational tenure and average number of years of education were calculated by summing the members' values and dividing it by the number of members in the teams. For team heterogeneity variables, two different approaches were utilized. For interval data, Allison (1978) observed that the coefficient of variation (the standard deviation divided by the mean) provides a direct method for obtaining a scale invariant measure of dispersion. In our study, it was appropriate for interval level variables with a theoretically fixed zero point and was used for age and organizational tenure. Team variables that were used in the analyses such as average age, average organizational tenure and average number of years of education were calculated by summing the members' values and dividing it by the number of members in the teams.

For team heterogeneity variables, two different approaches were utilized. For interval data, Allison (1978) observed that the coefficient of variation (the standard deviation divided by the mean) provides a direct method for obtaining a scale invariant measure of dispersion. In our study, it was appropriate for interval level variables with a theoretically fixed zero point and was used for age and organizational tenure. For the categorical variables, such as gender, Blau's (1977) index of heterogeneity ($1- \Sigma p_i^2$) was used, where p is the proportion of group members in a category and i is the number of different categories represented in the team. Before using the scales in questionnaires, authors that were originally used these scales were contacted via e-mail and necessary permissions were taken from them. The questions and scales used in the questionnaire were all translated from English to Turkish and then reviewed by three managers working in the industry and an academician to assure that no loss of meaning occurred during translation.

*Control Variable*

Team size has been seen as a factor in organizational demography theory which may affect group composition and as a result the organizational outcomes (Ancona and Caldwell, 1992; Blau, 1977; Eisenhardt and Schhonhoven, 1990; Thomas and Fink, 1963). Larger teams are likely to be more heterogeneous affecting the coefficient of variation. Therefore, team size will be regarded as a control variable in this study.

*Descriptive Statistics*

According to State Statistics Institute (DIE, 2002) 99.5% of the total number of firms are described as small and medium sized enterprises in Turkish Republic. The sample of the present study is formed by SMEs located in one of the leading industrial districts (Bursa) representing various sectors. 20.3% of these companies were operating in textile sector, 28.4% were in automotive sector, 10.8% were in chemical groups sector, 8.1% were in information technologies sector, 8.1% were in metal/rubber/packaging sector and 24.3% were in other businesses such as construction, printing, heating-cooling systems, logistics and consultancy. The average age of the companies was 18 years with a median of 14.5 years. 73.3% of the companies have employees less than 50 showing that sample is consisting of small companies with few exceptions.

The teams differ with regard to team formation modes. More than half of the teams (54.1%) were formed drawing upon family members and friends. Some 24.3 per cent of all teams emerged out of groups that had professional relations prior to firm's foundation. Only 4.1 percent of teams were formed under the lead of an investor. These results showed that Turkish SMEs chose their top management team members from among those with whom they have emotional kinship rather than emphasizing professional relations (Westhead et al., 2001).

The entrepreneurial team sizes ranged from two to twelve members, with average size being 4.04 (SD= 2.49). Totally, there were 299 members in 74 teams. Majority of the 290 top management team members was male (male=74.8%; female=25.2%), showing that top management teams were dominated mostly by men. The team members were on the average middle-aged (average=43.86, SD= 7.62). They had been employed at their current firms for about 11.17 years on the average (SD=6.73) with an average of 18.68 years of work experience (SD= 7.90). Respondents' had varying backgrounds such as operations/production, management, marketing/sales, finance/accounting and R&D. Educational levels attained also considerably varied, with elementary school (15.2%), high school (25.9%), two-year degree (10%), college degree (37.2%), master's degree (10%) and doctoral degree (1.7%). From the members that had at least college degree, 41% have technical education such as engineering or science whereas 59% had non-technical education in the areas of general business, finance/accounting, marketing/sales or law.

Table 1: Descriptive statistics

| Variable | Frequency | % |
|---|---|---|
| **Gender (N=290)** | | |
| Male | 217 | 74.8 |
| Female | 73 | 25.2 |
| **Age (N=272)** | | |
| 20-30 | 36 | 13.2 |
| 31-40 | 88 | 32.4 |
| 41-50 | 79 | 29.0 |
| Above 51 | 69 | 25.4 |
| | **Mean= 43.86** | **SD= 7.62** |
| **Education (N=290)** | | |
| Elementary school | 44 | 15.2 |
| High school | 75 | 25.9 |
| Two-year degree | 29 | 10.0 |
| College degree | 108 | 37.2 |
| Master's degree | 29 | 10.0 |
| Doctoral degree | 5 | 1.7 |
| **Tenure in the company (N= 267)** | | |
| 0-1 year | 14 | 5.2 |
| 2-5 years | 71 | 26.6 |
| 6-10 years | 78 | 29.2 |
| 11-15 years | 39 | 14.6 |
| 16-20 years | 21 | 7.9 |
| More than 21 | 44 | 16.5 |
| | **Mean=11.17** | **SD= 6.73** |
| **Tenure in general (N=248)** | | |
| 0-1 year | 5 | 2 |
| 2-5 years | 19 | 7.7 |
| 6-10 years | 46 | 18.5 |
| 11-15 years | 43 | 17.3 |
| 16-20 years | 37 | 14.9 |
| More than 21 | 98 | 39.5 |
| | **Mean= 18.68** | **SD= 7.90** |

Most of the firms tried to build networks with their customers (78.4%) and suppliers (77%), whereas networking with competitors (24.3%), universities (21.6%) and public organizations (36.5%) were relatively less frequent. The means, standard deviations, reliability coefficients and inter-correlations are presented for all variables in Table 2.

*Correlation Analysis*

Table 2 presents means, standard deviations, and Pearson bivariate correlations for the twelve variables in the study, along with alpha internal reliability coefficients for multiple-item scales. The correlation coefficients range between -0.012 and 0.579 (Table 2). The findings show that the innovativeness measures are positively and significantly correlated only with average age and age heterogeneity at the commonly accepted level of $p < .05$. Also, there is a weak positive correlation with average number of years of education ($p< 0.1$) out the six team composition variables studied. These correlations are consistent with past research. Other team variables such as gender heterogeneity, average organizational tenure and organizational tenure heterogeneity are not correlated with innovation.

All of the networking variables are significantly correlated with innovativeness. There are positive correlations between innovativeness and networking with customers ($p< 0.01$), networking with suppliers ($p<0.01$), networking with competitors ($p< 0.05$), networking with universities ($p< 0.05$) and networking with public organizations ($p< 0.01$).

*Regression Analysis*

The hypotheses were tested with three-step hierarchical regression analysis, with control variable and the team demographics variables as predictors of innovativeness. At step 1, innovativeness was regressed on the control variable -team size. At step 2, the team variables were added as a block to the regression model. At step 3, networking variables were added. Table 3 displays the results of the hierarchical regression analysis. The beta coefficients, or standardized regression coefficients, represent the strength of the unique relationship between a predictor variable and innovativeness after controlling for the effects of the other predictor variables in the regression model at that step. The $R^2$ statistics represent the amount of variation in innovativeness that is explained by all the predictor variables in the regression model at that step.

At step 1, the control variable team size explained a significant ($p < .05$) amount of the variation in innovativeness. At step 2, the addition of the team demographics variables brought about a significant ($p < .05$) increase in the amount of variation explained in innovativeness beyond that explained by the control variable. Age heterogeneity had a negative and significant ($p < .05$) unique relationship with innovativeness. This result supports Hypothesis 2. Average age has a unique negative relationship with innovativeness only at a level of $p < .10$ supporting Hypothesis 3. Average years of education has a unique positive relationship with innovativeness at a moderate level of $p < .10$. This finding validates Hypotheis 6. The rest of the findings fail to support Hypothesis 1,4 and 5 which proposes a positive relationship between variables *gender heterogeneity*, *average tenure* and *tenure heterogeneity* with *innovativeness*.

Table 3: Hierarchical Regression Analysis

| | **Organizational innovativeness Beta Values** | | |
|---|---|---|---|
| **Predictor Variables** | **Step 1** | **Step 2** | **Step 3** |
| **Control variable** | | | |
| Team size | 0.285* | 0.291* | 0.232* |
| **Team variables** | | | |
| Gender heterogeneity | | 0.021 | -0.053 |
| Average age | | -0.234[a] | -0.064 |
| Age heterogeneity | | -0.259* | -0.237* |
| Average organizational tenure | | 0.068 | -0.006 |
| Organizational tenure heterogeneity | | -0.056 | 0.115 |
| Average number of years of education | | 0.189[a] | -0.082 |
| **Networking variables** | | | |
| Networking with customers | | | 0.194 |
| Networking with suppliers | | | 0.192 |
| Networking with competitors | | | 0.183[a] |
| Networking with universities | | | 0.162 |
| Networking with public organizations | | | 0.343** |
| *Adjusted* $R^2$ | 0.069 | 0.175 | 0.420 |
| $R^2$ | 0.081 | 0.254 | 0.515 |
| $\Delta R^2$ | | 0.173 | 0.261 |
| $F$ | 6.377* | 3.217** | 5.399*** |
| $\Delta F$ | | 2.553* | 6.558*** |
| | | | |

[a] p< 0.1; * p< 0.05; ** p< 0.01; *** p< 0.001

At step 3 adding remaining variables about networking again increased the amount of variation explained significantly (p< 0.001) beyond that explained by control variables and entrepreneurial team characteristics. The analysis revealed that networking with public organizations had a significant positive effect on innovativeness (p< 0.01) along with a slight positive impact created by networking with competitors (p< 0.1). The results failed to support positive relationships between networking with customers, universities, suppliers and innovativeness.

## Discussion

In sum, we argue that entrepreneurial team characteristics and networking play an important role as an antecedent of innovativeness capability in small firms. However, the influence of the size of the entrepreneurial teams, that is controlled in analysis, is found significant in all steps. An optimum size for an entrepreneurial team should be sought for in order to make utmost use of human capital in creating innovative capability for SMEs.

Innovativeness is dependent on entrepreneurial team characteristics and the networking with various stakeholders. Our results In step 2 suggest that as age heterogeneity increases innovativeness is adversely influenced. This finding is consistent with previous research in that increasing age differences may increase potential for conflict which decreases consensus and cooperation over strategic targets such as enhancement of innovativeness capability. The negative moderate effect of average age on innovativeness indicates that younger entrepreneurial teams have more capacity and desire to innovate (Step 2). However, despite of their motivation and capacity to innovate, entrepreneurial teams may have fewer financial resources and fewer networks at earlier stages of their career. This will make having access to financial resources even more crucial.

Among factors that enhance innovativeness, educational level of entrepreneurial teams have been found to create a slight influence (step 2). This have implications on the entrepreneurship training provided by universities and other institutions. With proper programs of entrepreneurship training shortcomings in educational background can be eliminated. An interesting implication for future research is the impact of entrepreneurship programs on innovativeness.

Networking with public organizations is an important cornerstone of innovation. Through well designed government policies, SMEs can add more commercial value to their activities. Hence, governments need to review their innovation supporting programs to tailor with the capacity of entrepreneurial teams. Although governments may support innovation in SMEs, lack of proper training may curtail the effectiveness of such policies. The educational gap may be closed by various continuous training institutions. Also, in order to benefit from networking to boost innovative capacity, entrepreneurial teams should portray a homogeneous age distribution (step 3). Given the paternalism and strong state tradition (Heper, 2006) prevalent in Turkish culture, it is not surprizing to find public organizations perceived as having the sole significant effect on innovativeness (step 3). In support of this finding, Bugra (2007) also argued that Turkish private sector owed their existence to state. Given the nature of historical relationships, government organizations should take the lead in initiating such policies and programs as part of development programs. Communicating these policies to SMEs directly or by way of agents is another important aspect in making the networking more valuable. An important suggestion for future research here is the nature of contributions on innovativeness done by networking partners particularly public organizations. This will help to restructure the array of public policies aiming to mobilize SMEs towards both regional and national development.

In step 3, another significant relationship of minor importance is found between networking with competitors and innovativeness ($p < 0.1$). Networking with firms in same or different sectors may lead to sharing of knowledge, skills or technology and therefore is an important factor in increasing firms' innovativeness capacity. Therefore, policies to encourage networking with relevant firms may be initiated. Examples of such policies may be locating firms in industrial districts where proximity with competitors is enabled. An alternative is incubators where newly established firms are located under single roof. Such proximity will increase chances for learning by sharing information and skills. The conditions created will encourage innovativeness which will bring competitive advantage to small businesses.

It is interesting to find that the positive significant effect of education found in step 2 disappears in the third step changing also the direction of the relationship when networking variables are added into the regression analysis. This finding to some extend supports early findings concerning the mixed effect created by education. Such a change of the direction of relationship between step 2 and 3 is also observed in tenure, tenure heterogeneity and gender heterogeneity. These findings indicate possibility of interaction effects which can be further explored. However, for the time being, it can be stated that although average education and average age affect innovativeness in the absence of networking, but when the networking variables are introduced they tend to substitute the team characteristics in influencing innovativeness.

The research findings are subject to some limitations. Primarily, the data is collected from Bursa region which may not represent the whole country. Secondly, availability of entrepreneurial human capital does not adequately clarify how innovation takes place. Future research should therefore highlight the absorptive capacity and learning potential of entrepreneurial teams. Moreover, contribution of networking parties to innovativeness is a fruitful line of research. Particularly, the policies government adopts and their effectiveness in fostering innovativeness may be explored. However, the results belong to a pioneering research that shows the first direct effect of entrepreneurial teams and networking on innovativeness in Turkey.

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Note: The data of this research are from the MBA dissertation (in progress) of the former author at the Middle East Technical University, Ankara.

**Table 2: Means, standard deviations, alpha coefficients and intercorrelations for variables**

| Variables | $\bar{X}$ | σ | α | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1. Innovativeness | 4.25 | 0.82 | 0.895 | | | | | | | | | | | | |
| 2. Gender heterogeneity | 0.25 | 0.23 | n.a. | 0.103 | | | | | | | | | | | |
| 3. Average age | 43.86 | 7.62 | n.a. | -0.268* | 0.059 | | | | | | | | | | |
| 4. Age heterogeneity | 0.19 | 0.12 | n.a. | -0.270* | -0.179 | 0.098 | | | | | | | | | |
| 5. Average tenure | 11.17 | 6.73 | n.a. | -0.060 | 0.236 * | 0.524** | 0.046 | | | | | | | | |
| 6. Organizational tenure heterogeneity | 0.30 | 0.34 | n.a. | 0.027 | 0.012 | -0.058 | 0.341** | 0.272* | | | | | | | |
| 7. Average years of education | 13.38 | 2.92 | n.a. | 0.224[a] | 0.019 | -0.172 | 0.066 | 0.033 | 0.188 | | | | | | |
| 8. Networking with customers | 0.78 | 0.41 | n.a. | 0.389** | 0.177 | -0.213[a] | -0.133 | 0.029 | -0.112 | 0.373** | | | | | |
| 9. Networking with suppliers | 0.77 | 0.42 | n.a. | 0.408** | -0.003 | -0.080 | -0.057 | -0.012 | -0.145 | 0.308** | 0.572** | | | | |
| 10. Networking with competitors | 0.24 | 0.43 | n.a. | 0.285* | 0.131 | -0.115 | -0.160 | 0.057 | -0.128 | 0.087 | 0.298** | 0.310** | | | |
| 11. Networking with universities | 0.22 | 0.41 | n.a. | 0.269* | -0.020 | -0.092 | 0.085 | -0.037 | -0.003 | 0.348** | 0.116 | 0.287* | 0.161 | | |
| 12. Networking with public organizations | 0.36 | 0.48 | n.a. | 0.404** | 0.117 | -0.221[a] | -0.094 | -0.119 | -0.003 | 0.205[a] | -0.011 | 0.147 | -0.168 | 0.147 | |
| 13. Team size | 4.04 | 2.49 | n.a. | 0.285* | 0.107 | -0.056 | 0.066 | 0.037 | 0.355 ** | 0.068 | 0.102 | -0.108 | 0.003 | -0.035 | 0.124 |

[a] p< 0.1; * p< 0.05; ** p< 0.01

# SOFTWARE PRODUCTIZATION CENTER – SMALL BUSINESS INSTITUTE®: A CASE STUDY OF COOPERATION

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## Abstract

This paper chronicles the establishment and early experiences of the Millersville University Software Productization Center (SPC), and the coordination of its efforts with the University's Small Business Institute. The initial successes and struggles of the SPC are described. A review of the Center's development and approach are presented to offer a blueprint for possible replication elsewhere in academe. As a "case study" the paper is purely descriptive and without a related literature review.

## Introduction

In the summer of 2007 an interdisciplinary group of faculty joined together to prepare and submit a funding proposal to the Pennsylvania State System of Higher Education (PASSHE). This proposal was accepted and resulted in the awarding of a "PASSHE Planning Feasibility Study for University/Business Infrastructure Grant" in the amount of $182,541. This three-year grant was to establish the Millersville University Software Productization Center (SPC). The initial interdisciplinary faculty coordinating team included: Dr. Stephanie Elzer, Computer Science, Dr. Patrick McCaskey, Director of the Millersville University Small Business Institute (SBI), and Dr. Theresa Russsell-Loretz, Communication and Public Relations. In the fall of 2008, Dr. Nancy Mata, Art, joined the faculty coordinating team, and Dr. Theresa Russell-Loretz exited to pursue additional responsibilities at the University.

This article describes the establishment of the SPC, it's partnering with the SBI and the unique coordination that crosses not only departmental boundaries (Computer Science, Communications and Public Relations, Business Administration and Art and Design), but also spans two separate schools (The School of Humanities and Social Sciences, and The School of Science and Mathematics). Finally, in addition, the Office of the Vice-President for University Advancement was actively involved throughout the development of the grant application and the initial establishment of the Center's Advisory Board.

## The Software Productization Center:

The term "software productization" refers to the process of turning a rudimentary software concept or early prototype into a marketable product. Thus the efforts of the SPC are primarily focused on assisting local entrepreneurs with market research, the technical implementation of a working prototype of the software concept, the development of business and marketing plans for the launching of the product, and the branding and physical packaging of the product. Once the collaboration with the SPC is complete, the entrepreneur should be prepared to sell their product, either by attempting to raise additional funds (through business loans, angel investors, venture capitalists, etc.) or by directly selling to a customer base.

The model upon which the SPC is based, much like the SBI model, leverages faculty expertise to guide and mentor students working with the participating entrepreneurs. The students play key roles in the consulting relationship with the SPC clients. In fact, slightly over 40% of the grant amount is comprised of student salaries. The structure and focus of the SPC allows it to achieve several important benefits simultaneously: 1) strengthening the regional economy by assisting fledgling businesses (and hopefully thereby creating local jobs), 2) providing valuable practical

learning opportunities for Millersville students in multiple disciplines, and 3) increasing faculty awareness of the current issues facing regional businesses, thus facilitating the development of compelling and practical curriculum content.

Established in 2007, the mission of the Software Productization Center (SPC) at Millersville University is "to provide emerging technology-focused entrepreneurs within the Central Pennsylvania region with assistance in advancing software products from concept to marketable product". The Center accomplishes this mission utilizing faculty expertise, the assistance of student interns from various disciplines, and support from community business leaders and technology experts. The Center:

- Serves regional economic and community development needs
- Enhances the quality of instruction and learning resources available to students
- Links the University community to regional business, government, and nonprofit resources

The SPC collaborates with selected applicants to (1) implement a working prototype of the software product, (2) develop business and marketing plans for the launching of the product, and (3) design branding and physical packaging of the product. Eligible projects are restricted to software products that are intended to generate revenue and are still in the conceptual or very early development stages. Projects that are intended to support the business, but that would not be a source of revenue for the business, are not eligible and are not considered. The assistance provided by the SPC is in the form of guidance, expertise, and labor. No funds are directly provided to the selected clients, and no payment is solicited for these services. Once the collaboration with the SPC is complete, the client should be prepared to market the software product, either by attempting to raise additional funds through existing companies or venture capitalists, or by directly selling to a customer base. Eligible clients are entrepreneurs or businesses with revenue that comes (or will come) from selling software products. Clients are located in one of the several Central Pennsylvania counties. They fall into one of three categories:

- Individuals
- Startups (businesses with five or fewer employees existing for less than two years)
- Small businesses seeking to develop a new software product

An Advisory Board was recruited to assist and direct the activities of the SPC. Board members were sought who brought to the table certain experiences, knowledge and skills. These included:

- Software industry experience
- Knowledge of regional small business resources
- Small business experience
- Entrepreneurship experience
- Business startup experience
- Experience with small business legal issues
- Knowledge of venture capital and other forms of funding

The University's Alumni and Development Offices were consulted in the selection of the Advisory Board. However, it was held to be important, that this Board would serve no fund raising purpose. As a part of this consultation the Development Office also provided meeting space and food for the first two Advisory Board meetings. The SPC Advisory Board meets quarterly plays a vital role in the success of the center, including voting on the final selection of clients. The Board consists of seven regional business executives: (* = MU alum)

- *Mr. Daniel Betancourt, President and CEO. Community First Fund, a lending and support organization for startup businesses
- Mr. Charles Crystle, Founder, Mission Research, a highly successful software entrepreneur
- Mr. G. Yale Eastman, General Partner, Eastman Family Partnership, a scientist and retired founder of a successful high technology company, an angel investor and the only member of the Board whose picture has appeared on the cover of *Scientific American*
- *Ms. Jennifer Hammaker, Director of Business Development for the Innovation Transfer Network, a regional organization that supports cooperation between colleges and universities and business partners in technology commercialization
- *Ms. Cheryl Irwin, Vice President, Lancaster Chamber of Commerce and Industry
- *Mr. Scott Landis, Barley Snyder, LLC, an attorney specializing in corporate and small business law
- Mr. Jesse Stauffer III, CTO, GeographIT, a group leader at a high technology firm

**The Millersville University `Small Business Institute**:

The Millersville University Small Business Institute program at Millersville was established in 1986. Since that time the program has provided consulting support to approximately 300 local small businesses and an active learning experience to over 900 senior undergraduate business majors. Since its inception the Millersville University SBI has functioned as a participant in the parent national program.

(Much of the following material is drawn from various collateral material developed or revised for the marketing of the national SBI by one of this paper's authors while serving as the Vice-President of Marketing for SBI) Nationally the Small Business Institute began in 1972 as a cooperative venture between the U.S. Small Business Administration (SBA) and approximately 20 universities and colleges, with schools receiving $250 per completed case while providing free management assistance for clients. SBI initially grew, and over time more than 500 universities and colleges have participated. At present perhaps fewer than 100 universities and colleges have active, reporting, programs.

Over the years, since its inception, the Small Business Institute Directors' Association (SBIDA) served as the coordinating body for the SBI program. In the spring of 2002 SBIDA, in order to better reflect its members and interests, officially changed its name to the Small Business Institute. In 1996 the SBI program became independent of the SBA. The SBI program is now self-funded by participating schools through a variety of sources, including nominal client fees, student fees, donations, and state and local grants.

SBI member schools provide, under faculty supervision, small business consulting experience for their students and management assistance to small businesses in their community using the SBI model. Some local SBI programs work with community organizations to develop economic development strategies to bring businesses to the community as well as to develop businesses that already exist. Its estimated that, since its inception, SBI programs have benefited more than 200,000 small businesses. During this time more than 500,000 students have participated.

Each local SBI program operates within a College or Department of Business or Management under the authority granted by the national SBI. Participating students enroll in courses such as Small Business Management, Small Business Consulting, Business Policy, Strategic Planning, Applied Management, Independent Study, etc.

Each local SBI program uses student teams of two to four senior-level or graduate business students, under faculty supervision to conduct in-depth consulting and field case projects to analyze and create solutions for specific business problems. Each local SBI program is uniquely customized to meet the needs of the market it serves based on the expertise available at the sponsoring school. For example, some local SBI programs work with small businesses in the area of technology transfer while others provide assistance in the development of advertising and promotional campaigns or marketing research. Each local SBI student team meets frequently with the small business owner over the course of the academic term to learn about the owner's goals and the business's history, to observe operations, and to identify opportunities and specific problems. Each local SBI student team usually focuses on a limited number of opportunities or problems, conducting an in-depth analysis of the business and its industry prior to recommending action to the small business client. At term's end, each local SBI student team delivers comprehensive written and oral reports recommending courses of action or solutions to the client

The SBI model of student consulting offers several benefits to the participating faculty. SBI clients' problems offer opportunities for incorporating real-life examples in lecture material thus improving teaching by increasing the student's retention level. SBI clients' problems offer case writers new ideas for case development. SBI clients' problems and implementation results, as well as student problems and successes, offer research opportunities that can lead to publishable material in numerous small business journals. Working with SBI clients and coaching student teams to discover solutions serves as a pseudo-internship for faculty without managerial experience.

The SBI model also offers significant benefits to the participating students. The SBI program offers students a chance to gain hands-on experience with small business, the economic sector providing the majority of new jobs. The SBI program provides the critical experiential training which supplements textbook and classroom knowledge, making students more immediately productive on the job. Participation in the SBI program can lead to greater job opportunities, quicker promotion, reduced training, or more advanced responsibilities after graduation.

The SBI model offers valuable benefits to the participating colleges and universities. The SBI program is an excellent means for a university to provide community service. The SBI program enhances the credibility of the management curriculum for both the community and prospective students, which can enrich the diversity of the student body or increase its size. The SBI program enhances recognition of the management program among the university's constituents, which can lead to more financial contributions and grant opportunities.

The local business community also benefits through their participation. Businesses receive consulting at a nominal fee or at no charge. As a result of successful SBI consulting projects, SBI clients have been found to create new jobs within the community. As a result of successful SBI consulting projects, SBI clients have been shown to generate additional gross and net revenues.

## The Cooperative Effort

As can be gleaned from the descriptions offered above of the two programs, there are many similarities and some differences between the two. The goals and potential benefits are essentially the same or, at least, quite similar, for: the faculty, students, schools and clients for both the SPC and the SBI. Both programs are offered at no charge to the clients. Both programs are designed to focus on the learning experience, and as such are easily classified as educational in nature. Both offer the students academic credit for their participation. A conscious effort is made with both to complete projects within the time frame of either one or two academic terms. In as much as some SPC projects take longer they may differ from a more typical SBI project. While it has not yet been an issue, in such instances the SBI team may be offered internship credits and compensation beyond the first term. As an SBI team they are during the first term working within the framework of the SBI course and are not compensated. Since no comparable course structures exist in their departments, the students from Computer Science, Communications and Art generally participate as paid interns. While there are some obvious inequities in this situation, each student pays tuition to participate and, to date, due to the richness of the experience, this has not been seen as problematic from the SBI students' perspective.

Supervision requires careful cooperation among the participating faculty. For example the SBI students have course responsibilities that the other students do not have. Specific assignments have required that the students have had to report, from time to time, to faculty outside of their discipline. Extensive teambuilding is necessary not only among the students but also the faculty. As much as possible, an ego free approach has to be maintained. Each of the participating disciplines speaks a separate language and exhibits different work ethics. Thus there has been a significant learning process, not only among the students, but also the faculty, as we have developed the ability to cooperate.

The University has been highly supportive of this interdepartmental effort. Both Deans involved have actively participated in the process. On several occasions one or both have been present to introduce the faculty team at public announcements or public programs associated with SPC. In addition, the Alumni and Development offices have been helpful. At the outset of the planning for the program, due to the organizational structure of the University, the team felt it was essential to involve their offices in the process. One reason for the support of the administration has been the use of external funding resulting from a successful grant application. The SPC program has also had a good deal of positive local press coverage. The careful use of press releases with the grant award, the naming of the Advisory Board, the various calls for client applications, and most recently, a planned rollout party for one client's product has led to high visibility for the SPC in both print and television coverage.

## What Is Next?

The SPC program was funded by a three year "PASSHE Planning Feasibility Study for University/Business Infrastructure Grant". When the Advisory Board was put together one issue was to find a group who would not only offer excellent advice and guidance, but could through their contact and support also assist the team in locating continuing funding. The feasibility funding came from the PA State System of Higher Education. Now the SPC must determine if there is sufficient reason to take the program further, and if there is, locate long-term funding support. The SPC team is now working with the Advisory Board and the University's Development Office to properly fund the operation beyond year three.

# CHANGING THE ECONOMIC CLIMATE THROUGH ENTREPRENEURSHIP: REBUILDING RURAL AMERICA

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## Abstract

This paper describes a process and outcomes from a yearlong action research project designed to infuse the "E" spirit into eight rural communities in the Commonwealth of Kentucky. The project used local talent to solve local issues around new business start-ups related to economic changes and major changes at a local military base. The project's purpose was to address rising unemployment by changing the local culture and expectations from "taking a job" to "making a job." Reports and research findings will be given to participants of this session.

## Executive Summary

On July 1, 2008 the Workforce Investment Board of the Lincoln Trail Administrative Development District awarded Western Kentucky University a $400,000 contract to help develop the entrepreneurship spirit in the eight county area served by the Lincoln Trail Administrative Development District (LTADD). The Contract was divided into four phases.

*Phase I – Entrepreneurship Spirit Development*

- Introduced entrepreneurship as a regional economic development model.
- Regional approach – eight Kentucky counties.
- Marketing program – "Don't take a job – make a job!" Local media advertising reached several hundred thousand people daily.
- Funding – contract supported local small businesses sponsoring an Entrepreneur Academy of Excellence and Think Tank Institute.
- Sustainability – set the stage for project continuation.
- Local Support – local business people (pro bono).

*Phase II – Entrepreneurial Academy of Excellence*

- Established first Entrepreneurial Academy of Excellence (EAE) for the LTADD Region.
- Developed an introductory entrepreneurship curriculum.
- Trained 102 county enrollees on starting a business (386+ work session hours).
- Used local accountants, attorneys, small business owners and others in curriculum development.
- Used entrepreneurs as mentors.

*Phase III – County Descriptive Studies*

- Descriptive study of each of the eight counties with a strategic plan framework.
- Copies of the studies to be used in future EAE sessions.

*Phase IV – Think Tank Institute*

- Comprehensive regional planning process.
- Institute identified 95 local small business owners and entrepreneurs interested in economic development through entrepreneurship.
- Institute was facilitated by outside consultants for an impartial viewpoint.
- Proceedings for the Think Tank Institute to be used to set the stage and to identify new business start-ups for the future.
- County Descriptive Studies given to all registered Think Tank Institute members.

## Introduction

*Rural Economic Models*

There have been many different economic models for rural America. Many of those models have involved single county and/or city governments purchasing land for the purpose of building regional/national industries – the Industrial Park Model. The idea behind this type of economic development is to provide the space, labor force, and opportunity, and to encourage the "big box company" and/or "manufacturing company" to move into the district (Lee, 1995). While this model has been successful in the past, with the decline of the manufacturing industry in the United States this has become a less attractive model. This model also depended upon a large local labor force, normally with minimal education and skills; thus, to some extent this model perpetuated a population with relatively low skills.

Other models have been built around some technological development and the attraction of a number of related industries that can play off of and build a rapport between different, but related industries. An example of this would be Silicon Valley in California. Other examples could also relate to the healthcare business, such as a mega healthcare industry in Nashville, TN.

The economic development philosophy through local entrepreneurship is a unique model. The decision made by the Workforce Investment Board to fund and implement this approach is unique, different and exciting. It provides local citizens the opportunity to develop their own ideas and to become self-sustaining. In the case of the Lincoln Trail Area Development District, this has unique appeal since a major transformational change is occurring at Fort Knox. With an influx of additional military personnel, plus approximately 2,500 civilian employees, the need in local culture is likely to change drastically. This will bring about the demand for new and different services not currently available in the local area. For example, the transfer of civilian employees from Alexandria, VA and from St. Louis, MO are likely to bring different cultural ideas and also different demands on the local economy; therefore, local people have the opportunity to develop new and exciting business ventures to meet these particular needs. This approach also keeps the local revenue generated by the new entrepreneurs in the given region as opposed to being moved to some corporate headquarters either in the United States or possibly in a foreign country.

## Program Description

In June 2008, the Workforce Investment Board from the Lincoln Trail Area Development District issued an RFP to develop and implement an Entrepreneurial Academy of Excellence (EAE) serving the eight counties of the LTADD. The eight counties to be served by the EAE were: Breckinridge, Grayson, Hardin, LaRue, Marion, Meade, Nelson, and Washington. Several proposals were submitted in response to the RFP. After being reviewed by the Workforce Investment Board, two proposals were deemed to have merit. Those two proposals were from The Center for Entrepreneurship and Innovation at Western Kentucky University in Bowling Green, KY and one from the Elizabethtown Innovation Center in Elizabethtown, KY. The board requested that these two proposals be merged into one consolidated regional approach to entrepreneurship and economic development. Having just transferred his research and development work from Vanderbilt University, Dr. R. Wilburn Clouse was named as Principal Investigator and Mr. Mo Miller was appointed as Local Coordinator. This arrangement combined the best of academia with a well-known local entrepreneur, which provided the project with an opportunity to spread the spirit of entrepreneurship throughout the eight counties. The News Release for the Academy is shown in Exhibit A.

*Mission*

This project's goal was to infuse the entrepreneurial spirit in the Lincoln Trail Area Development District, to encourage new business start-ups, to improve the economic conditions, and to sustain a vibrant local economy. The slogan was "Making Jobs, not Taking Jobs." By promoting creativity, innovation and entrepreneurship, the EAE nurtured a new generation of entrepreneurial thinkers for the Lincoln Trail Area Development District. The process was a unique initiative to support innovative efforts for economic development for the Lincoln Trail region by creating an entrepreneurial community and nurturing potential entrepreneurs to translate their dreams into realities while creating jobs and increasing the tax base for the region. In early July, the Principal Investigator and Local Coordinator met with members of the LTADD Staff to discuss the details and requirements for the contract. It was decided that during the first year the EAE would conduct a series of introductory courses related to economic development through entrepreneurship. Four sites were chosen to conduct EAE introductory entrepreneurship sessions, including the Elizabethtown Technical and Community College and WKU campus sites at Radcliff , Bardstown and Lebanon. The Western Kentucky University Center of Entrepreneurship and Innovation worked jointly with the local Innovation Center and other important resources, including the Small Business Development Center, Elizabethtown Community and Technical College, WKU Division of Extended Learning and Outreach (DELO), LTADD entrepreneurs and professional practitioners who supported the EAE efforts.

*Objectives*

1. To develop a process to promote and sustain the entrepreneurship spirit in the 8 county area of the Lincoln Trail Area Development District (LTADD).
2. To provide a forum for interested parties to discuss new economic trends, business ideas and possible new ventures and to learn how to take these ideas to the marketplace.
3. To develop learning scenarios that foster entrepreneurial activities that lead to creative and innovative thinking about new business ideas and ultimately new business start-ups.
4. To provide a network of services between local entrepreneurs and business leaders.
5. To identify potential entrepreneurs.

6. To provide local and virtual coaching services and mentorship development.
7. To utilize local talent and local resources to identify and develop new economic issues.
8. To encourage the concept of making jobs vs. taking jobs.
9. To motivate the individual who has good ideas, but who may need some assistance in moving their idea forward.
10. Commercialization of new ideas.
11. Linking new ideas with appropriate funding sources.
12. To develop a model for transferability of the EAE to other area Development Districts.

The services offered an Introduction to Entrepreneurship and included the following areas:

1. Overview of the Business Development Cycle
2. New Idea Development Process
3. Business Models and Business Plans
4. Legal Overview
5. Financial Considerations
6. Accounting Considerations
7. Marketing Plans
8. Personal Relationships

*Curriculum*

The curriculum was designed to be an Introduction to Entrepreneurship as represented by the Activity Syllabus.

*Marketing*

Since the EAE was an innovative concept for the LTADD, it was necessary to develop a comprehensive marketing strategy to reach local citizens. An aggressive radio and newsprint campaign was set into motion, which included a carefully designed script developed in conjunction with local radio stations WXQE, WULF and WLSK. Broadcasts started 4 weeks before each of the EAE sessions. During the week the message was broadcast to more than 250,000 people, four to five days a week. This provided an active forum to spread the concept of making jobs as opposed to taking jobs. Since these eight counties are considered to be rural in nature, this may have been the first time that many citizens were made aware of the possibility of taking an idea and moving it to the marketplace.

A comprehensive marketing program was also developed for each of the local county and/or regional newspapers. Ads were placed in the following print media: News Enterprise, the Independent, the Turret - Larue County Herald, Grayson County Record, Kentucky Standard, Lebanon Enterprise, Springfield Sun, Meade County Messenger, and the News Enterprise and Independent magazine editions. A brochure was developed for distribution to the Chambers of Commerce and interested parties. A copy of the print ads, brochures and Chamber of Commerce Letters are provided in Exhibit B.

*Registration Process*

Through the marketing campaign, we were able to provide potential participants with a website address to register for each of the sessions. The website was part of the Center for Entrepreneurship and Innovation site at WKU, and provided the project with contact and qualifying information for each registered participant.

*Attendance*

The comprehensive marketing campaign not only helped build the spirit of entrepreneurship in the eight county LTADD, but also attracted more than 100 participates for the EAE sessions. The breakdown by each session site is provided in Exhibit C.

*Think Tank Institute*

As a part of the EAE, the project staff developed and implemented a Think Tank Institute for the eight counties. The institute was held on April 24, 2009 at the Tourism and Convention Center in Elizabethtown. More than 90 people expressed interest in the Institute, attended and participated freely in discussions related to new business ventures for the region. We are reporting some of the details from the Think Tank Proceedings because of the importance of the findings on possible new start-ups. A complete copy of the Proceedings is shown in Exhibit D.

This was a one-of-a-kind event for Elizabethtown and the 8 surrounding counties. The major features of the Institute are as follows:

1. The Institute was held in the Elizabethtown Tourism and Convention Bureau Conference Center, thus identifying the event with local facilities.
2. More than 90 people had registered for the Institute and at least 85 persons were present.
3. The Institute was comprised of local small business owners, entrepreneurs, elected officials, developers and venture capitalists.
4. The Institute was designed to maximize creative and innovative thinking.
5. The Institute began with a friendly, heartwarming opening session.
6. The keynote address was given by Jim Fugitte, a local entrepreneur.
7. The Institute participates were provided with support materials and identifying leading questions for the institute.
8. Luncheon speech was presented by Tom Cellucci, Chief Commercialization Officer of the Department of Homeland Security in Washington, DC.
9. The Institute participants had been carefully placed in groups related to county interests.
10. The Institute contained the following sections: Opening Session, Breakout Session 1, Lunch and Networking, and Session 2 with closing comments.
11. The Institute identified the major weaknesses and strengths of each of the 8 counties, although several of the counties were in one group due to low population and low attendance from those counties. The outcomes of the groups' deliberations may be summarized into five main categories: 1) Major Strengths, 2) Major Weaknesses, 3) Major Resources, 4) Industries Identified, and 5) Most Likely Start-up Businesses. The complete list is available in a handout, but it is worth noting that the major strengths identified by the groups revolved around seven general areas: 1) People, such as labor force availability, population growth, and multi-cultural growth, 2) Planning, with communication and collaboration highlighting the list, 3) Geographic location at the center of major transportation and trading areas, 4) Cultural positives such as friendliness and shared traditional values, 5) Security, 6) Presence of adequate support for business in the form of utilities, and 7) Good support of social services such as education and healthcare. Major weaknesses seemed to center on the need for vision and shared voice, both leadership issues.

12. Entrepreneurial Academy of Excellence – There were several strong comments about the effectiveness of the Think Tank Institute and the desire to continue the entrepreneurship efforts placed in motion by the Entrepreneurial Academy of Excellence funded by the Workforce Investment Board. A strong desire was expressed to continue the Think Tank operations in order to continue to develop strategic plans for each of the counties and to help develop a symbiotic relationship among the 8 counties to act and perform as an economic region. The TTI could help develop the "E" spirit in the region by helping develop areas such as:

    - Expanding economic development
    - Improving human welfare
    - Creating self-reliance
    - Maximizing personal ideas
    - Learning to dream in new and different ways for the new developing economy
    - Changing a rural manufacturing, farming environment to a viable high-tech environment
    - Developing an environment to "create jobs" and not to "take jobs"
    - Working collaboratively with county management
    - Developing relevant training programs with local universities and technical training centers
    - Developing the Entrepreneurship Spirit by seeing new opportunities.

*Regional Informal Steering Committee*

During the development of the EAE we identified the opportunity to establish an informal steering committee for the Academy and Think Tank Institute. On a voluntary basis, entrepreneurs, city and county leaders, and small business owners shared their time and ideas via an information session almost each month for the project. This activity was funded by the Center for Entrepreneurship and Innovation at WKU and became a sounding board for ideas, concepts, improvements, and new venture developments. Although this was not part of the original proposal, it did become a very interesting and vital part of the Academy. All Agendas and meeting minutes are shown in Exhibit E.

## Methods

*County Descriptive Studies*

In support of the EAE and the TTI, a County Descriptive Study was conducted for each County – Breckinridge, Grayson, Hardin, LaRue, Marion, Meade, Nelson, and Washington. The County Study provides information related to market research and includes items such as location, population, culture, school systems, points of interest or uniqueness of each county and others items of interest that would be helpful in developing new products or services for the county and region. Complete County Descriptive Studies are shown in Exhibit F. See Exhibit G for details on the Entrepreneurial Academy of Excellence Reports to the LTADD WIB .

*EAE Committed Practitioners*

Seven sessions were established for each of the four EAE training locations. Thirty-two local entrepreneurs and professional practitioners were identified to participate in the sessions and to provide mentoring advice. They represented finance, banking, law, accounting, and entrepreneurial disciplines. A complete listing of names is available via handout.

*Analysis of EAE Enrollees*

Table 1 below details registrant information collected from ninety-six EAE website responses for the fall and spring, 2008-2009 EAE sessions. Notable highlights include a majority of registrants from Hardin and Nelson counties (76%); approximately one third of registrants were in the 43 to 48 year-old range. Gender representation was almost equally divided.

Table 1. Registrant Information

| County | Registrants | | Male | Female | 24-30 | 31-35 | 36-42 | 43-48 | 49-56 | 57-65 | 66+ |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Breckinridge | 2 | 2% | 1 | 1 | | | | 1 | 1 | | |
| Bullitt | 1 | 1% | | 1 | | | | 1 | | | |
| Grayson | 3 | 3% | 1 | 2 | | | 2 | | 1 | | |
| Green | 1 | 1% | 1 | | | | | | | 1 | |
| Hardin | 56 | 58% | 31 | 25 | 9 | 6 | 8 | 19 | 9 | 2 | 1 |
| Jefferson | 1 | 1% | | 1 | | 1 | | | | | |
| LaRue | 3 | 3% | | 3 | 1 | | | | 2 | | |
| Marion | 6 | 6% | 3 | 3 | 1 | | | 1 | 4 | | |
| Meade | 1 | 1% | | 1 | | | 1 | | | | |
| Nelson | 17 | 18% | 8 | 9 | 4 | 2 | 2 | 2 | 4 | 1 | 1 |
| Radcliff | 1 | 1% | | 1 | | 1 | | | | | |
| Taylor | 1 | 1% | 1 | | | | | 1 | | | |
| Washington | 3 | 3% | 1 | 2 | | | | 2 | 1 | | |
| | 96 | | 49% | 51% | 16% | 11% | 14% | 29% | 24% | 4% | 2% |

**Analysis of EAE Sessions**

Table 2 provides information about each of the four EAE locations-- Elizabethtown, Bardstown, Radcliff, and Lebanon. As shown in the table, a total of 102 participants attended the 28 sessions with the most participants from Radcliff and the fewest for the Lebanon site. The total number of enrollee hours in work sessions was 546 hours. The total number of dropouts was 28 enrollees, but some dropouts were due to the bad weather during the Radcliff sessions. The total number of probable start-ups was 12.

## Expanded Marketing Strategy

The Entrepreneurial Academy of Excellence reached thousands of listeners and readers over its roughly six-month media campaign. Approximately $55,000 in radio and print media accomplished two important goals:

1) Attracted considerable attendance to 32 entrepreneurship training sessions held throughout the LTADD at four separate locations.

2) Promoted the eight county Lincoln Trail Area District as one in which the spirit of entrepreneurship is clearly in force.

Table 2. EAE Location Information

| | Elizabethtown | Bardstown | Radcliff | Lebanon | Total |
|---|---|---|---|---|---|
| Number of Work Sessions | 7 | 7 | 7 | 7 | 28 |
| Number of IT Sessions: Excel & QuickBooks | 12 | 16 | 16 | 12 | 56 |
| Total Enrollees | 23 | 24 | 45 | 10 | 102 |
| Enrollee Hours in Work Session | 131 | 135 | 205 | 75 | 546 |
| Enrollee Average Per Session | 17 | 17 | 27 | 9 | 70 |
| Practitioners Participating | 17 | 13 | 13 | 12 | 55 |
| Average Practitioner Hours | 2.4 | 1.9 | 1.9 | 1.7 | ---- |
| Practitioner Hours in Work Session | 34 | 32.5 | 32.5 | 30 | ---- |
| Average Age of Enrollees | 36.45 | 39 | 39 | 41 | ---- |
| Currently Employed | 100% | 100% | 100% | 100% | 100% |
| Drop Outs | 6 | 9 | 12 | 1 | 28 |
| Probable Business Startups | 4 | 3 | 3 | 2 | 12 |

In a region where employment loss due to the contraction of the agricultural workforce is stillongoing, it is most important to be able to change the mindset, the overall public attitude that exists. "Make a job, don't take a job" is easy to say, but very hard to internalize into support, from dedicated secondary education to area banking services. Moreover, the actual number of those who act independently as classic entrepreneurs is, at any one time, quite small. Very likely, the largest number of target consumers of EAE entrepreneurship media campaigns are those interested in becoming more entrepreneurial, but who lack the combination of incentives, either attitudinal or circumstantial. Over time, consistent exposure to regional opportunities for entrepreneurship should improve this cohort’s willingness to take different kinds of economic risks, and consistent media exposure should certainly help to enforce that decision.

*Targeted Marketing: Ages 36 through 56 Demographic*

Over two thirds of EAE website registrants indicated they were in the 36 through 56 year-old demographic. In addition to obvious media placement choices of drive-time radio and print media placement, additional marketing efforts may include billboards and sporting event sponsorship. Trade (law enforcement, fire, other state agencies) and farm journals are also viable media contact points for targeted advertising.

## Strategic Program Additions

*Broad and Expansive Participant Contact*

Independent entrepreneurship successes are built one at a time, so it is useful to consider broader or deeper ways of reaching existing participants. Strategies to do so could include:

- An interest survey, effectively an "E-spirit diagnostic" completed at the beginning of the training and coaching sessions, combined with an exit survey to determine resource efficacy
- Ongoing invitations to connect with EAE activities such as Think Tank Institutes, WKU entrepreneurship courses, and/or regional economic development conferences sponsored by local, state, national or academic entities.
- Ongoing communication strategies to include e-mail newsletters, and e-mail news lists to update participants in real time
- Connecting with statewide resources

*Business-to-Business Entrepreneurship*

The Think Tank Institute component of the EAE has been successful in outlining specific business strategies and start-up opportunities for the LTADD. The next opportunity may be to connect area businesses with each other to determine what synergistic opportunities there may be in all phases of production, product or service delivery, marketing, human resources or logistics.

*Expanded Regional Venture Investment Angel Summit*

Concurrent with training and accelerator/incubator-based strategies, the Lincoln Trail Area will benefit from expanded exposure to regional and national private investment opportunities. There is currently an effort to connect local entrepreneurs with interested investors on the local level through the Lincoln Trail Venture Group; however, attracting interested investors or entrepreneurs across a broader region requires a concerted effort from a referral-neutral organization such as the EAE, which has as its stated goal regional economic advancement, but importantly has no industry or community bias.

A well-organized and promoted venture capital summit hosted by the EAE would have considerable legitimacy as an impartial provider of important financial backing. Moreover, the not-for-profit status of WKU ensures a positive reception. In forums held by banks or service providers, there is often an implicit bias to showcase the organizers' services; as an ecumenical provider of entrepreneurship opportunity, WKU will receive serious attention from those who are interested in financing and those in receiving financing, with the assurance of impartiality.

More precisely, the Angel Investors Summit would seek to educate those interested in becoming Angel investors, those interested in receiving Angel funding and those successful current investors who are interested in expanding their portfolios. A one and one half to two-day series of seminars, venture presentations, and important social gatherings will be the general format outline.

## Conclusions and Implications

In July 2008, a $400,000 contract was award to Western Kentucky University to develop a curriculum for entrepreneurship and to infuse the entrepreneurship spirit into the eight counties surrounding Elizabethtown. The counties are as follows: Breckinridge, Grayson, Hardin, LaRue, Marion, Meade, Nelson and Washington.

As a result of that contract a very successful Entrepreneurial Academy of Excellence was designed and implemented in the region. The EAE identified four locations and held seven training sessions in each of the four locations. A comprehensive marketing plan, both by radio and print material, was developed to identify potential participates in the EAE and also in the Think Tank Institute. EAE participants developed a host of new ideas.

As part of the EAE, a Think Tank Institute was also held on April 24, 2009. This Institute was the first of its kind to bring together local entrepreneurs and small business owners to identify and develop a comprehensive planning process to infuse entrepreneurship into the eight county area. More than 95 people participated in this planning process and a Proceedings was printed from the process.

The Entrepreneurial Academy of Excellence initiative and the Think Tank Institute represent a continued evolution in the spectrum of community economic development. The specific and grassroots nature of the opportunities derived are substantively different from the generalized strategy of attracting big box or single industry opportunities to a given area.

Why is this so important? As evidence of the project's relevance, we include a brief description of selected models that use the Industrial Park Model. As late as 1995, some still held that economic development was an externally focused effort, bent upon attracting a single firm or discrete industry to solve a region's problems through a series of interlocked incentives: discounted land, tax breaks, training initiatives or other inducements. Over time, these tax incentives often never returned a significant payback to the community, either because the underlying economic advantage evaporated or the business relocated once the incentive structure was no longer meaningful. Witness the following 1995 excerpt from "Industry Help of a Small Rural Community" from the Alabama Cooperative Extension System:

> If your community leaders decide they want to expand the local economic base by attracting industrial jobs, citizens must be willing to meet the following conditions:
>
> 1. Prepare to welcome new people and new ideas into the community
> 2. Provide the tax base of support for buying land in providing public facilities and services that are essential industrial growth.
> 3. Build, finance, and staff organizations that can give the leadership necessary to attract new plants to the area and to encourage existing plans to remain and expand.
> 4. Develop a positive community attitude that will be attractive to industrial prospects. (Lee, 1995)

Moreover, according to Deller, pursuing large single industry manufacturing as the Holy Grail to hold a region's economic fortune is at best a problematic gamble.

> *Because of the political pressures of short-term election cycles elected officials expect local economic development practitioners to focus their engines on recruitment of larger firms. While the odds successful recruitment of large firms are relatively low in the long-term commitment of the grid firms is questionable, the pressure to pursue such approaches comes at the expense of working with smaller firms. In short the political reward for working with small businesses in the name of economic growth and development is not sufficiently visual in the public eye when compared to show business recruitment efforts.* (Deller, 2007)

The EAE represents a synthesis of local political support, skills training, and harnessing of specific dedicated entrepreneurial energy that supports preconditions for economic development. These expressions of intellectual capital, created by the EAE initiative, significantly influence the likelihood of economic opportunity creation. According to Singletary, other forces are at play.

> *It cannot be deduced from research that infrastructure investment leads directly to regional development, at state and local governments continue to pursue industrial recruitment by physical infrastructure and development. Lack of research on the impact of human resource investment local or regional economic growth causes communities not to value education as a means of creating economic opportunities.* (Singletary, 1990)

So then, if physical infrastructure is hardly the defining variable it was once thought to be, then what role can educational programs like the EAE play? It seems reasonably clear that physical infrastructure is not by itself a necessary and sufficient precursor to economic development.

We are pleased to offer this report and analysis of the EAE activities and TTI process. It is our belief that the cohesive nature of the model this engagement has produced goes far in addressing the deficiencies in the traditional recruitment model of economic development. The stage is now set for the next continuation of the E-spirit infusion into the eight county areas. With the County Descriptive Studies and with the Proceedings from the Think Tank Institute, materials are now available to move to the next level and to establish a second round of EAE sessions that could focus on the needs of the region with the influx of both military and civilian people and to the region.

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# ETHICS CODE IMPLEMENTATION IN THE UNIVERSITY

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## Abstract

The Association to Advance Collegiate Schools of Business (AACSB) has encouraged the teaching of ethics in management curricula and has mandated the implementation of ethics codes within the university setting. A preliminary study of the use of ethics codes in AACSB accredited universities did not find the required implementation. Rather schools are using a patchwork of components that fall short of the integrated approach envisioned by the AACSB. This study compares what accredited schools are doing and while the number of fully implemented ethics codes is small, a preliminary best practices is proposed.

## Introduction

Publicly traded companies are now required to operate codes of ethics, and to report regularly on their use. The Sarbanes Oxley Act of 2002 legislated the use of ethics codes with the assumption that they encourage ethical behavior. Similarly, many professions, i.e., physicians, lawyers, accountants, engineers, etc. have used ethics codes both to discipline members and as a condition for maintaining licensure.

Business Schools are required by the AACSB to teach, "Individual ethical behavior and community responsibilities in organizations and society." So, we are required to teach the use of ethics codes as a way to help ensure ethical behavior on the part of corporate participants.

Despite this agreement that ethics codes are useful, and with an AACSB mandate to teach ethics, business schools in general and even business schools that have sought accounting accreditation are unlikely to have an operating ethics code. This research describes the implementation of the components of an ethics code within the accredited university.

## Review of the Literature

Sarbanes Oxley mandates the use of a Code of Ethics by publicly traded companies as follow:

> *The Commission shall issue rules to require each issuer, together with periodic reports required pursuant to section 78m(a) or 78o(d) of this title, to disclose whether or not, and if not, the reason therefore, such issuer has adopted a code of ethics for senior financial officers, applicable to its principal financial officer and comptroller or principal accounting officer, or persons performing similar functions.* (SEC, 2002)

The Sarbanes Oxley Act of 2002 was passed by Congress as a reaction to corporate misdeeds in the early 2000s. The choice of such a prescription must be that the existence of an ethics code could have prevented such abuses. "Research has shown that the existence and enforcement of codes of ethics are associated with higher levels of ethical behavior." (Ferrell & Skinner, 1988)

Consequently, the nation's business schools have also been asked to emphasize the use of ethics codes as part of management education, "The institution or the business programs of the institution must establish expectations for ethical behavior by administrators, faculty, and students."(AACSB, 2009; also Brand 2009; Lambert 2003)

In addition, the AACSB has required ethics to be a component of the curriculum, requiring that management education include "Individual ethical behavior and community responsibilities in organizations and society." (AACSB, Standard 15)

Within the accounting literature an effort has been made to encourage the development of academic ethics codes, for example, "Given the attention in recent years that ethics has received in accounting education…A proactive establishment of such standards…(will) have the widest possible acceptance." (Loeb, 1994).

Conversely, there are those that oppose the idea of mandated ethics codes governing universities. The principle of Academic Freedom is frequently cited as conflicting with a code of ethics. "The American Association of University Professors has sharply criticized the Stevens Institute of Technology for its proposed institutional code of ethics, which the association said constitutes a serious threat to academic freedom." (Lipka, 2005) Others argue that the presence of honors codes and other student conduct codes as well as research codes of conduct make an ethics code unnecessary, or at least redundant.

And further, that Academic Freedom is such a fundamental principle that critics also argue, "The only immediate guarantee of the teacher's observance of his obligation to his students is his serious devotion to his calling, his belief in the value of what he teaches, and his conviction that it is eminently worth knowing." (Shils, 1978)

Finally, codes of ethics include an element of discipline that seems to reduce an individual's freedom to act, which is apparently assumed under academic freedom:

> *More practically speaking, when the motivation is self-interest, decision-making is likely to be reduced to utilitarian risk–reward calculations. If the risks from ethical behavior are high, such as loss of reputation and value in the market for executive talent and the associated loss of wealth – or the risks from unethical behavior are low and the reward is high, such as low probability of unethical activity being caught and if it is, the consequences are minimal – the moral principles succumb to expediency. This is no small problem in all walks of life. People cheat, plagiarize, lie on resumes, distort or falsify facts at work, commit accounting fraud and much more, for exactly the reason of utilitarian convenience and suitability. But the real test of our code of ethical conduct is whether we are willing to do the right thing – the thing that could serve as a maxim for everybody's acting – even when it is not exclusively in our self-interest.* (Micewsky, 2007)

## Research Question

An ethics code should be part of a company's orientation and training for all employees. As an outsider to an organization one would normally look on the corporation's homepage, under a link such as "corporate governance." The Sarbanes Oxley act requires the use of ethics codes, so searching virtually every publicly traded company will find the code and the required disclosures. Certainly this information would be available through the Edgar links at the SEC.

Similarly, in the University setting the ethics code should be part of faculty training and student orientation. Visiting a university's webpage and using the links and search engines should discover the program, and helpful links to navigate through the process, especially if you were trying to make use of the program during an incident. If the universities have operating ethics codes they are not easy to find by reference to their web pages. This research set out to describe what is found on university pages.

## Methodology

The research sample for this study was chosen from the published list of AACSB accredited institutions. The list was randomized, and a sample of seventy five schools was chosen. This sample produced forty five schools that have the business accreditation and thirty schools that have both business and accounting accreditation.

Each school's website was visited and the homepage was reviewed for links that would lead to an ethics code. In addition, the school's search engine was utilized to find the use of such a code, using the following key words: Ethics; Ethics Codes; code of Conduct; Ethics Officer; Ethics Hotline; Ethics Helpline. The Business School's homepage was also visited and reviewed for the same potential links. Academic honesty policies are often known as "honor codes" so this term was used as well.

## Results

The investigation took place during the Spring and Fall of 2009. Seventy five websites were visited and scanned and searched to determine the existence of an ethics code on that campus. The scanning process included the homepage, and first level links, and the search terms mentioned above.

The websites were analyzed using a four point scale:

High – Thorough Code of Ethics: in terms of visibility and level of University responsibility

Medium – Significant Code of Ethics: some application, but failing in some characteristics.

Low – Some mention of a code, or use of an off-campus code, for example a reference to a state code.

None – no reference to a code of ethics.

In addition to the scoring of the site on the four point scale, any existing components of less than a comprehensive ethics implementation were noted:

- Does a statement of ethics exist and is it prominently displayed and easily found on the webpage.

- Websites very often had reference to individual professional codes of ethics, for example, the Accounting department might refer to the CPAs Code of Professional Conduct, or the Engineering, Psychology or Nursing Departments make reference to their individual professional codes.

- Almost all websites made reference to a Student Code of Conduct, which usually addressed academic dishonesty and in many cases student conduct in the university's residential system.
- All university websites listed courses in ethics, including the business schools, and many had established centers for the study of ethics, usually in the field of business, but often in bio-ethics, or the field of psychology. Most sites had some reference to a code of research ethics.
- Since many of the schools were publicly funded, there were some that made reference to the State Code of Conduct that was imposed by the nature of that funding.
- In addition, several schools had codes of conduct within their administrative offices, especially in the purchasing departments, or internal audit functions.

Out of the seventy five schools searched there were only ten (14%) that qualified for the highest designation and fifty six (75%) had none. Seventeen schools were given the medium or low designation. Schools with accredited Accounting programs were slightly less likely to have the highest designation, in that only three (10%) schools qualified. The results of this work are presented below in two tables. Table one indicates the overall score for the sample of business accredited and business/accounting accredited institutions.

Table 1. Number of Schools With High to None Implementation

| Cat | High | Med | Low | None |
|---|---|---|---|---|
| All | 10 | 6 | 12 | 47 |
| Acct | 3 | 2 | 2 | 23 |
| All | 13% | 8% | 16% | 63% |
| Acct | 10% | 7% | 7% | 76% |

N = 75, N-Accounting = 30

Table two highlights some of the components that were available on campuses. For example, the existence of formal written ethics policies were only present on 13% (10% accounting) campuses, while most schools (89%) had courses, often multiple courses, on ethics.

Table 2. Ethics Code Components in the University

| Component | Business Accredited | | Accounting Accredited | |
|---|---|---|---|---|
| | Count | Percent | Count | Percent |
| Written Statement | 10 | 13 | 3 | 10 |
| Student Conduct* | 63 | 84 | 26 | 87 |
| Professional Codes** | 56 | 75 | 21 | 70 |
| Research Codes*** | 1 | 1 | 1 | 3 |
| Institutes for the Study of Ethics | 20 | 27 | 7 | 23 |
| Courses on Ethics**** | 67 | 89 | 27 | 90 |

*includes student honor codes, academic honesty as well as residential life codes.
** includes administrative codes for offices such as admissions or internal audit as well as disciplinary codes such as CPAs, Psychologists, etc.
*** these were not found with the search parameters used, others search terms would probably find higher rates
**** Ethics courses at the university regardless of the school.

To help further this project, the following list are the campuses which had implemented complete ethics programs:

- Boston University
- Kent State University
- Northern Illinois University
- Old Dominion
- Rutgers-The State University of New Jersey-Newark/New Brunswick
- Southern Illinois University Carbondale
- University of Alaska at Anchorage
- University of Houston
- University of Illinois at Springfield
- University of Texas, Permian Basin

## Conclusions and Further Research

Ethics Codes on university campuses are generally a mixture of student codes of conduct, individual professional codes, or administrative codes. Most schools do not have in place the universal codes envisioned by the Sarbanes Oxley legislation, or the AACSB overall prescription. It seems that most schools teach ethics but have not determined that it is necessary to operate under a code of ethics. Ethics is a subject to be taught, but not practiced is the conclusion of this first round of investigation.

The role of academic freedom is a complication that needs further research. It is probably not true that academic freedom is at odds with a code of ethics, by virtue of the ten schools that are operating a high quality ethics code. Research should be performed to determine how faculty and staff at those institutions view academic freedom.

The AACSB Standard 15 requires the implementation of ethics across the university and within the business school. How are the 47 schools that did not qualify for even the low designation in this research meeting this expectation? It is likely that they meet the standard by pointing to the student codes of conduct, various professional codes and some of the codes within the administrative offices such as purchasing. Interviews with these schools would determine the answer to that question. It is also possible that the schools in question actually have codes of ethics, they are just not easily found on the websites. Why did the search terms used not turn up the necessary links? Perhaps an effort at improving the visibility of the ethics codes is all that is necessary. Research within the student bodies, or the faculty at these institutions would uncover how they view ethics questions and how they resolve ethical conflicts.

Finally, it would be helpful to identify the best practices. Starting with the eight schools that qualified in this research what are the elements that make for an effective code of ethics.

## Best Practices – A Preliminary List

If the school has a code of ethics then make it easy to find by placing a link on your home page, or on your academic affairs and your student pages. Place the right headings on these linked pages so a search will find it. Use the search engine and see what is revealed when “ethics code” is entered.

The code needs to address the various participants in the university setting. Faculty, staff and students have different needs when it comes to an ethics code. The assignment of an ethics officer is an appropriate way to raise the visibility of such programs. Confidentiality is an important element of an ethics code implementation, so the school needs to consider engaging the services of a confidentiality hotline system.

If the school does not have an ethics code:

- Initiate faculty discussions about the implementation of a code of ethics.
- Visit the websites mentioned above and review their implementation.
- Consider ethics training at all levels, but particularly among the faculty and staff. Students will come later.

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# PROMOTIONAL STRATEGY FOR EASY MEAL PREP STORE

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## Abstract

This case involves a couple opening a "healthy" easy meal prep store. The industry is rapidly changing with many stores going out of business. A promotional strategy must be developed if their new store is to succeed. The industry is examined as well as regional and customer demographics. Social networking media and customer engagement are emphasized.

## Introduction

Andrew and Carol Marshall decided to open "My Healthy Kitchen", an easy meal prep store in the Raleigh-Durham, North Carolina area. Andrew currently works as a chef in an upscale restaurant, and Carol manages a local health food store. Because they both have a passion for healthy meal preparation and eating, they decided to follow this passion and open a health-food easy meal prep store. According to Michael Pollan, an author of two food books, what people care most about is what they should eat for their health and the health of their families (16). Although forecasts for organic product sales had not been good, 2008 saw an increase of 15.8%. A survey by the Lieberman Research Group on behalf of the Organic Trade association found that organic food sales grew at a faster rate than general food sales in spite of a slump in pricier foods (12). This data was instrumental in their decision.

In March 2004, the first easy meal prep store opened in Raleigh. Carol heard about the store from her sister Ann. She could not say enough about the quality of the food and how much time it was saving her in the evenings after work. Carol told Andrew about it, and they decided to go see what Ann was raving about.

## The Concept

Delicious, ready to heat and eat meals make life much easier for a professional woman who has little time to cook for her family. Nutritious home-cooked meals are more appealing than fast food or take-out. In just two hours, 6-12 meals can be prepared and only require thawing and heating. All of the ingredients and recipes are arranged for the customer who assembles the meals and places them into freezer containers for later use. The cooking time is determined by the entrée and whether it is frozen or not. The "super moms" who juggle work, children's activities, and other obligations feel better about what they are serving their families for dinner. Singles, empty nesters, and seniors also frequent easy meal prep stores.

## The Industry

New easy meal prep stores open and close frequently around the country. Most are privately owned single stores, some are multiple stores, and more and more are franchises. The start-up costs for this industry are fairly reasonable. Many people believe that it is a straight forward business mode, and, therefore, no prior experience in the food industry is needed. Basically, all that is needed to set up a store is a commercial kitchen, a storefront in a heavily trafficked area, and an appealing interior design. The actual start-up costs are $20,000- $500,000 (See Table 1). Branding is difficult because there are very few ways to distinguish one store from another. New entrants merely have to look at the industry standards, evaluate some of the companies in the area, and incorporate best practices.

Table 1. Initial Start-up Costs

| Initial Start-up Costs | | | |
|---|---|---|---|
| Category | Low-cost | Typical | High-end |
| Equipment | $12,000-$43,000 | $42,000-$53,000 | $42,000-$73,000 |
| Website and Software | $3,000-$18,000 | $8,000-$18,000 | $18,000-$30,000 |
| Build-out | $0-$6,000 | $50,000-$100,000 | $100,000-$300,000 |
| Upfront Marketing | $1,000-$5,000 | $2,000-$20,000 | $2,000-$30,000 |
| Recipes | $1,000-$5,000 | $2,000-$5,000 | $5,000-$15,000 |
| Losses before Breakeven | $2,000-$20,000 | $10,000-$30,000 | $10,000-$50,000 |
| Other | $2,000 | $2,000-$10,000 | $2,000-$10,000 |
| | | | |
| Totals | $21,000-$100,000 | $116,000-$236,000 | $179,000-$508,000 |

Easy meal prep stores are “neighborhood” stores similar to a supermarket. The surrounding community is the market. Therefore, it is not unusual to see stores opening up within a mile from each other. Large supermarket chains and upscale grocers are “getting into” the meal prep business. It is a natural product extension for a supermarket to enter the easy meal segment of the market. The incentive is enhanced by the fact that supermarkets frequently have lease agreements that specifically state that “no competitive stores may occupy a storefront in the strip mall in which they reside”. One can argue that supermarkets are not direct competitors because the customer does not prepare the meal. Instead, in the refrigerator cases of most supermarkets there are fresh, pre-packaged, ready-to-cook meals. Entrees such as chicken cordon bleu, meatloaf, beef stew, and crabmeat stuffed salmon can be purchased at very reasonable prices.

The easy meal prep industry is experiencing a downturn as of 2008. According to the Easy Meal Prep Association, in March 2007, there were 395 companies and 1,270 outlets. As of March 2009, there were 317 stores and 701 outlets. Total count for stores is down 36% in the U.S. in 2009 vs. 2008 (2). Different regions in the U.S. have experienced varying loss of stores, but all the regions are down at least 23% in that time period (See Table 2). The Southeast Region, to which the Raleigh-Durham area belongs, has seen a 28% loss in number of stores. Within the Southeast Region, North Carolina has fared a little better with a 24% loss (See Table 3).

Table 2. Regional Numbers of Stores

| Regional Numbers of Stores | | | | | | | |
|---|---|---|---|---|---|---|---|
| States | Year | | | | | | Decrease 08 vs. 07 |
| | 2002 | 2003 | 2004 | 2006 | 2007 | 2008 | |
| New England | | 1 | 3 | 42 | 56 | 43 | 23.21% |
| Southeast | | 5 | 17 | 218 | 282 | 203 | 28.01% |
| Pacific | 4 | 21 | 50 | 232 | 281 | 185 | 34.16% |
| Mid Atlantic | | 2 | 5 | 83 | 139 | 91 | 34.53% |
| South Central | | 2 | 30 | 128 | 121 | 79 | 34.71% |
| North Central | | 10 | 39 | 293 | 315 | 177 | 43.81% |
| Mountain | | 5 | 29 | 127 | 159 | 89 | 44.03% |
| | | | | | | | |
| Total | 4 | 46 | 173 | 1123 | 1353 | 867 | 35.92% |

Table 3. Southeast Stores

| Southeast Stores | | | | | | | |
|---|---|---|---|---|---|---|---|
| State | Year | | | | | | 08 vs. 07 |
| | 2002 | 2003 | 2004 | 2006 | 2007 | 2008 | |
| Alabama | 0 | 0 | 0 | 4 | 7 | 8 | 14.29% |
| Florida | | 2 | 5 | 74 | 92 | 64 | -30.43% |
| Georgia | | 1 | 6 | 33 | 39 | 25 | -35.90% |
| Kentucky | | 1 | 2 | 8 | 8 | 11 | 37.50% |
| Mississippi | | | | 2 | 2 | 2 | 0.00% |
| North Carolina | | | 1 | 39 | 51 | 39 | -23.53% |
| South Carolina | | | | 15 | 15 | 9 | -40.00% |
| Tennessee | | | 1 | 17 | 26 | 18 | -30.77% |
| Virginia | | 1 | 2 | 26 | 42 | 27 | -35.71% |
| West Virginia | | | | | | | |
| | | | | | | | |
| Total | 0 | 5 | 17 | 218 | 282 | 203 | -28.01% |

Revenues in the industry are $270 million, and analysts predict that by 2010, revenues will exceed $1 billion. The average store revenue in 2006 was $400,000. New stores tend to have less than 30% repeat business, while established stores can have over 50% repeat business(4). As reported by Mark Albright, St. Petersburg Times Staff Writer; a local entrepreneur stated, “People are starving each other out. Nationwide, average store revenues leave little after rent and expenses (17).

There are many franchises in the easy meal prep industry. Some of the largest franchisers are: Super Suppers, Dream Dinners, Dinner by Design, Entrée Vous, and The Dinner A'Fare. Super Suppers and Dream Dinners have almost 200 stores each (4). It is estimated that a Super Supper franchise requires an initial investment of $ 200,000. Clearly franchises enjoy economies of scale as they can reduce costs by purchasing supplies in large quantities. Franchisees frequently have menu preparation, web sites, and bookkeeping assistance provided by the franchiser (1). Many use major suppliers such as Costco and Sam's Club and distributors such as Sysco. Some use their own farms for fresh herbs and vegetables. Franchises are also experiencing losses in the number of stores (4).

## The Raleigh-Durham-Cary Market

Raleigh, Durham and Cary are in a region in the Piedmont of North Carolina. Raleigh and Durham are the two major cities in the area. In 2006 the number of new jobs was the highest it has been in the last few years. More companies are coming into the region. The biggest job growth is in professional and business services (7). This region is home to three prestigious research universities: Duke University, University of North Carolina at Chapel Hill, and North Carolina State University . The research excellence of these three universities attracts numerous high-tech companies and enterprises. The universities also provide the education needed to have a strong workforce (7).

The greater Raleigh area is home to 1.5 million people. The growth of the Raleigh-Durham-Cary area far exceeds that of the U.S. as a whole and that of North Carolina. North Carolina has seen a population growth of 15% in the last eight years while the major cities around Raleigh have grown 21% (12). While all of the counties in this area show a positive growth, Wake County, Raleigh's county, is the fastest growing. Raleigh is the fastest growing city in this area (7).

The Raleigh-Durham-Cary area is very well educated. More than 40% of its citizens have a four year college degree or higher (See Table 4).

Table 4. Education Levels

| **Bachelor Degree or Higher** | |
|---|---|
| County | % of Population |
| Chatham | 27.6% |
| Durham | 40.1% |
| Franklin | 13.2% |
| Harnett | 12.8% |
| Johnston | 15.9% |
| Orange | 51.5% |
| Person | 10.2% |
| Wake | 43.0% |
| CSA Average | 36.1% |
| N.C. Average | 22.5% |
| U.S.A. Average | 24.1% |

Wake County is the wealthiest county in the area with a median household income of $61,700. This income level is higher than both North Carolina and the U.S.A. (See Table 5).

Table 5. Median Incomes

| **Raleigh-Durham-Cary Median Household Income 2007** | |
|---|---|
| | |
| County | Income - 2007 |
| | |
| Chatham | $53,164 |
| Durham | $47,885 |
| Franklin | $44,683 |
| Harnett | $39,649 |
| Johnston | $47,773 |
| Orange | $55,028 |
| Person | $42,140 |
| Wake | $61,706 |
| Average | $54,846 |
| North Carolina Average | $44,472 |
| U.S.A. Average | $50,746 |

The Raleigh-Durham-Cary area is young. Almost 60% of the population is between the ages of 20 and 59. Nineteen percent are under the age of 20—which would imply a large workforce of parents (See Figure 1).

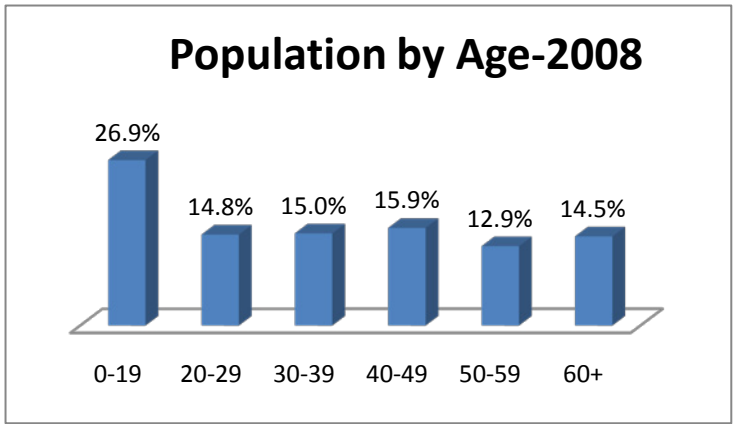


**FIGURE 1**
**2008 Raleigh-Durham-Chapel Hill Population by Age (7)**

The Raleigh-Durham economy is growing and therefore more professionals will continue move to the area for professional jobs. Most area residents work in the same county in which they live (See Figure 2).

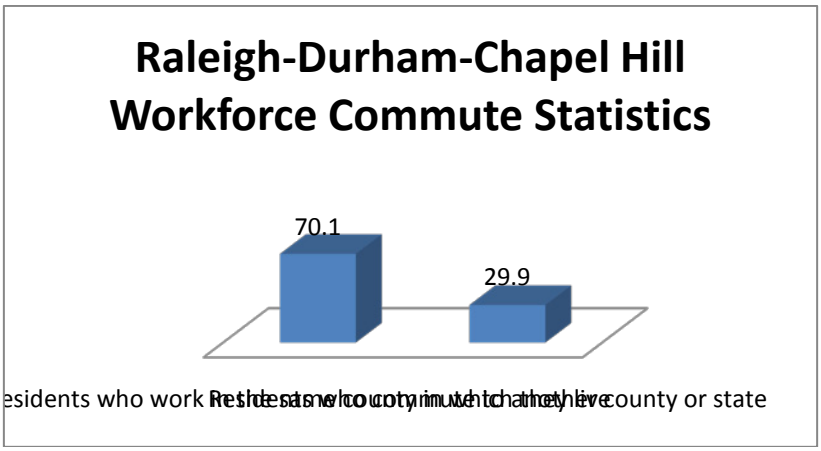


**FIGURE2**
**Workforce Commute Statistics (7)**

Raleigh is a terrific city for professionals according to MONEY and Forbes. In 2006, MONEY ranked Raleigh as #4 in *Best Big Cities*. In 2007, Forbes ranked Raleigh #1 in the *Best U.S. Cities to Find Employment* survey (15).

## The Competition

There are several easy meal prep stores in the Raleigh-Durham-Cary metropolitan area. Super Suppers, Supper Thyme, Entrée Vous, and Entrees Made Easy have franchisees in the area. Most of the stores are single stores not franchises. All but two of the easy meal prep stores are located in shopping centers or strip malls. Some are within two miles of each other. Two stores closed after being in business for six months and one year, respectively. There are currently no health food easy meal prep stores in the area.

The Mixing Bowl and Dinners at Home have distinguished themselves from the other easy meal prep stores. The Mixing Bowl has an exquisite selection of wines, and a "learning about wines" class. Dinners at Home can adapt easily and well to the different dietary needs of its customers. With 24 hours notice they can have non-fat, gluten-free, sugar-free, and without wheat or MSG. The other competitors use the basic business model "prepare 6-12 meals in two hours" (2).

Supermarkets and specialty stores offer products that are in direct competition with the easy meal concept. Kroger and Harris Teeter have a large selection of freshly made meals. Whole Food also prepares organic meals to take home and cook. Gourmet stores like Simple Pleasures Market, Dulet, and Hickory Market on Main, are very popular with the Baby Boomers. Earth Fare and Harmony Farms prepare organic and health ready to go entrees. Piggly Wiggley and Publix are placing easy meal prep centers in their grocery stores on a limited basis in other states (4). Schwan's, a home delivery company, delivers frozen foods in the Raleigh area. Every two weeks, they will delivery from over 400 products, all with a 100% quality guarantee. The delivered items include breakfast and lunch items, appetizers, entrees, side dishes, and desserts. This competition can affect most locations. Numerous health food stores, such as Whole Foods Market, and organic restaurants are located in the Raleigh-Durham-Cary area (12).

The Marshall's first-year goal is to have $ 300,000 in revenue and a profit of $75,000 They recognize the need for a 15% growth rate per year and a goal of 40% repeat customers to meet these financial goals.

## The Customer Experience

The typical customer is looking for convenience, time, location, ease of preparation, and quality of food. All buyers expect stores to be clean, the food to be fresh, and the staff to be helpful. Cost and menu selection may also be important.

### What Distinguishes High-Volume Stores?

To succeed, a meal prep business needs high revenue. Seven attributes of high volume stores that are thought to contribute to their success are:

- Almost all high volume stores and high volume regional chairs have at least one owner with experience in sales and marketing or in advertising and PT.
- High volume storeowners tend to have large personal networks and use these to fill the store during the initial months.
- High volume stores generally did well in generating favorable PR during the first 3-6 months of opening. Because of the difficulty of explaining the concept, newspaper articles and television stories have been the most effective.
- High volume stores are well-run operations. There is a lot of attention to detail in every stage of the process.
- Some high volume stores in more crowded markets have succeeded by providing an innovation or pursing a new niche not well served by competitors.
- High volume stores focus on customer satisfaction. Many high volume stores do little discounting.

**As printed in the Easy Meal Prep Association Newsletter, March 2007 (1)**

*Registration and Arrival.* Most stores have web sites that provide general information, monthly menu selections, and open appointment times. Customers may register on-line for a session or call the store. Credit cards, checks and cash are all usually accepted. When customers arrive, they are provided with aprons and containers for their entrees. Some stores provide snacks and beverages for their customers. Most are asked to bring a cooler or laundry basket to transport their entrees home from the store.

*Meal Preparation.* Customers move from one preparation table to another. Each station is stocked with all of the ingredients needed to prepare the various entrees. Recipes are provided with simple instructions, and even those who do not cook have no trouble assembling the meal. Customers combine the required ingredients and have the option of making minor changes to meet their individual tastes. The entrees are then packaged in containers provided by the store or brought by the customer. Space permitting, some stores allow the customer to bring a friend to split the work and share the entrees. Typically, the entrees may be divided into two smaller portions—frequently for a small, additional charge.

Most stores encourage customers to schedule private parties of eight or more. The host will typically receive a bonus, or the entrees will be discounted slightly. A party atmosphere is created with food, drinks, music and whatever else the customer requests.

*Entrée Selection and Prices.* Customers are given an option of preparing 8, 10, or 12 entrees per visit. Most stores provide 12 to 14 entrees from which to choose. Proven favorites are frequently repeated while new items are added monthly. Most of these entrees serve four to six people.

Costs can vary for entrees. Some stores have different prices depending on the cost of the entrée. Most stores charge a set fee for the session based upon the number of entrees prepared. Prices range from $169 to $225 for 12 entrees and $135 to $175 for 8 entrees.

Side dishes and desserts are available for purchase at some stores. Recipes for sides and dessert may be provided**.** Some stores are stocking cooking accessories, condiments, and other products that they believe will be valuable to their customers.

While most customers attend a two-hour session, some prefer to have their entrees prepared for them for pickup or delivery. Not all stores provide these services, but those that do charge a premium price for the additional service. Two to three dollars more per entrée for store preparation is not unusual. Delivery costs vary and the average cost is about $25.00**.**

*Nutritional Information.* Detailed nutritional information about the entree is usually provided. The people who develop the monthly menus are sometimes nutritionists and professional chefs on staff. Others stores are owned and operated by people who love to cook and get pleasure from working with customers to provide nutritional meals to meet customer demands.

*Cancellations*. Most stores have cancellation policies. A common practice is that if the cancellation is made five days in advance, there is no penalty. Less time may result in a charge or the requirement that the store will prepare your entrees for pickup with a preparation cost.

## Operations

*Preparation Processes.* Monthly: Menus must be chosen and web sites updated. Weekly: The ingredients must be ordered, obtained and prepared in a timely fashion. Daily and weekly deliveries, shopping trips, and distribution must be scheduled. Daily ingredient preparation is very time consuming.

*Employees.* Initially, the store should not need many employees. The number is dependent on the number of customers and how much time the owners are willing to devote to the operations. Typical positions include: managers, assistant managers, session helpers, food prep helpers, dish washers, and janitorial staff.

## Marketing Strategies

The Marshalls must explore various tools for promoting their new store. The competition used a variety of marketing tools such as: money-off coupons; newspaper ads, infomercials, radio advertising; newsletters; brochures; and direct mailings. As competition increases, there are more creative ideas, major TV spots, incentives, strategic alliances, and gimmicks.

Most stores have web sites with store information and registration capabilities.

**How to Make Your Website Work for Your Business**

The store's website appears to play a significant role in attracting customers. Although no website meets everybody's needs, some score higher than others. Customers indicate the following characteristics as important:

- Easy to find the menu and schedule a session
- Pictures of food items
- Fewer words are better
- Easily located contact information
- Simplicity in the order process
- Carefully structured site so changes are easy to make
- Simple navigation through the site
- No "turn-offs" such as possibly annoying music, colors, visuals, or problematic displays/formatting
- No long domain names and names that are easy to misspell

**As printed in the Easy Meal Prep Association Newsletter, March 2007 (1)**

**Price Promotions that Work**

Many high-volume stores do not rely on low pricing or special promotional offers to generate volume in their stores. Some "tried and true" approaches to price promotions that appear to work for easy meal prep business are:

- Give something away for free to anyone who signs up for a session next month while they are in the store. The most typical freebie is a dessert or cooking dough that the customer can have as an instant reward.
- Work with a charitable cause and allow a percentage of any order to go to this charity.
- Provide a value bundle to encourage customers to purchase more.
- Give a one-time try-it special.
- Give referral points that can be used to get free meals or discounts to anyone that refers other customers to the store and those customers purchase something.

**As printed in the Easy Meal Prep Association Newsletter, March 2007 (1)**

*Incentives*

Stores offer various enticements to either grow the customer base or improve retention of existing customers. Summers are traditionally slow for the food prep industry so additional enticements such as entrée discounts, free sides and desserts, and free entrée preparation are offered. Frequent customers, and those who refer customers, receive incentives at many stores. New moms often receive several months free entrée preparation.

*Customer Engagement*

According to James Eiloart, senior vice president sales, UK, Europe and Asia Pacific, Alterian, "Traditional marketing as we know it is dead. Engaging with customers in a two-way dialogue, connecting online and offline channels within an analytics framework, and fully measuring the value of each individual customer is the way of the future**.**" (9). Steve Grout, Targetbase Claydon Heeley, UK CEO, sees this as a technology driven revolution. He believes "The changes we are seeing are a result of the connected world around us. With social networks and the emergence of web and GPS enabled mobile phones, people are now always online and always contactable by friends, family and brands."(9).

Customer engagement (CE) refers to the engagement of customers with one another, with a company or a brand. CE can be either online or offline. Online customer engagement is very different from offline engagement as the nature of the customer's interactions with a brand, company, and other customers differ on the internet. Customer Engagement marketing efforts that aim to create, stimulate or influence customer behaviors differ from the offline, one-way, marketing communications that most marketers are familiar with (19).

People's online engagement with one another has brought about both the empowerment of consumers and the opportunity for businesses to engage with their target customers online. Customer engagement in online communities, interact directly or indirectly around product categories and other consumption topics. This means that consumers can now choose not only when and how but, also, if they will engage with marketing.

CE is the solution that marketers have devised in order to come to terms with the social, technological and market developments. It is the attempt to create an engaging dialogue with target consumers and stimulate their engagement with the brand. Although this must take place consistently both on and off-line, the internet is the primary vehicle for doing so.

Creating and stimulating customer engagement behavior has recently become an explicit aim of both profit and non-profit organizations which believe that engaging target customers to a high degree is conducive to furthering business objectives. It enhances customer loyal (retention), word of mouth advertizing (advocacy), complaint behavior (fewer complaints to other customers; rather than directly with the company), and marketing intelligence--where the customer provides recommendations for improving quality of offering. (19)

Marketing practices that seek to include the customer aim to:

- persuade target customers that the company or offering is worth their time, effort, money and commitment.
- create, stimulate, or influence customer engagement behavior.
- In order meet these goals, it is necessary to:
- Identify where CE marketing efforts should take place; which of the communities that the target customers participate in are the most engaging?
- Specify the way in which target customers engage, or want to engage, with the company or offering.
- Measure how successful CE-marketing efforts have been at engaging target customers (19).

*Social Networking*

The Marshalls have been researching a few social networking tools for marketing purposes. Social networking has become extremely popular. There are various opportunities for social networking to be used by business. Some of these include:

- MySpace
  MySpace is a social networking website which allows users to create profiles, meet people, browse other users' profiles, and make friends from all around the world. It handles blogs, photos, music and videos (13).

- Twitter
  Twitter is a free social networking and micro-blogging service that enables its users to send and read messages known as *tweets*. These text-based posts of up to 140 characters are displayed on the author's profile page and delivered to the author's subscribers who are known as followers. Senders can restrict delivery to those in their circle of friends or allow open access. While the service costs nothing to use, accessing it through SMS may incur phone service provider fees (15).

- Facebook
  Facebook is a social networking website which connects people with other users who work, study and live around the world. People use Facebook to keep up with friends, upload an unlimited number of photos, share links and videos, and learn more about the people they meet (8).

  According to Jefferson Graham in USA today, "120 million Facebook users log on at least once a day and 30 million of them access Facebook on mobile devices." The fastest growing demographic is people 35 years and up. This wide exposure and ability to market to a targeting audience explains why so many businesses use Facebook (3). Recently, an Australian marketing has begun to sell lists of 1,000 potential new customers for less than $200 (5).

- You Tube
  You Tube allows for display of videos. These videos may be viewed on personal web pages, blogs, and some mobile phones and video game consoles. Videos are limited to ten minutes in length and a file size of 2GB. Various channel types are available which can be used to make the users' video more distinctive. Channel types that lend themselves to marketing include: (1) Guru, videos produced by people who are experienced in certain fields, (2) Reporter, videos produced by civilians or professionals about local or international news and current events, and (3) YouTuber, videos produced by general viewers of YouTube (19).

- Blogging
  A blog is a type of website, where a person regularly posts entries of commentary or other material such as graphics or video. The blogs have the ability for others to leave comments in an interactive format.

There are many different types of blogs, differing not only in the type of content, but also in the way that content is delivered or written. Some of these types which lend themselves to promotional activities are: (1) corporate blogs which are used internally for communication purposes or externally for marketing, branding, or public relations and (2) blogs that focus on a particular subject, such as political blogs and travel blogs (9).

## Conclusion

The Marshalls are ready to start their new business. They have given much thought to what their mission would be and have come up with the mission statement, "To provide nutritious, delicious, and all natural ready-to-cook meals so that the ones you love stay healthy". Their first-year goal is to have $300,000 in revenue and a profit of $75,000.
Due to the volatility of the easy meal prep industry, they know they must have a powerful marketing strategy if their new business is to succeed.

The Marshall must analyze the industry as a whole and then look at specifics as they pertain to their geographical area and concept. The marketing strategy must look at the marketing tools available as they apply to the demographics of the Raleigh-Durham community.

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## Teaching Guide

1. Customer engagement is an important concept in the promotional area. The types of customer engagement may differ based upon the customer demographics. Do you feel customer demographics influence the most effective type of customer engagement? If so, how? If not, why not?
2. What type of customer engagement would be appropriate for the Marshalls?
3. Social networking tools are becoming increasingly popular as tool for marketing. What demographics lend themselves to these tools?
4. Develop two marketing strategies for the Marshalls to use for their business.

# ENCOURAGING FUTURE SOCIAL ENTREPRENEURS: COMMUNITY OUTREACH AND MBA'S

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**Abstract**

Running a nonprofit program…is much more like running a small business than it is like being a professional in a large corporation (Masaoka, 2009.) Recent studies have indicated concern about future leadership of the nonprofit sector, questioning whether the sector can effectively recruit a workforce that will meet current and future needs. This paper introduces a unique MBA course that uses Service Learning to introduce potential nonprofit leaders and social entrepreneurs to this sector.

## Encouraging Future Social Entrepreneurs: Community Outreach and MBA'S

Increased attention and support have been given recently to public service, volunteering, and service learning. President Barack Obama has pledged to strengthen three types of service: an occasional day of volunteering; a longer period (a year or two) with service organizations such as Teach for America or AmeriCorps; and careers in nonprofit organizations or government agencies (Light, 2009).

The Edward M. Kennedy Serve America Act, passed by Congress in April 2009, also supports volunteerism and public service with Summer and Semester of Service programs and educational awards for youth, a September 11 National Day of Service, and a Silver Scholars program of service for individuals 55 and older who perform 350 hours of service (Corporation for National & Community Service, 2009). The Act also authorizes Nonprofit Capacity Building grants which provide assistance with organizational development to small and mid-size nonprofit organizations, as well as a Volunteer Generation Fund whose grants strengthen the nation's volunteer infrastructure.

These actions are well timed, and in some minds, overdue. With the downturn of the economy, human services needs, among others, have increased; while at the same time nonprofits are already struggling with pressing needs to provide services and sustain ongoing programs. While financing these operations is a continual concern, recent studies have indicated a cause for concern about future leadership of the nonprofit sector (Tierney, 2006; Cornelius, Corvington, & Ruesga, 2008).

Some question exists whether the nonprofit sector, with 1.1 million registered organizations, and 11 million employees (Stroup, 2006), can effectively produce or recruit tomorrow's nonprofit leaders and workforce. Several statistics paint a scary picture of the nonprofit leadership crisis. Three quarters of nonprofit executives plan to leave their current jobs within five years (Bell, Moyers, & Wolfred, 2006). The Bridgespan Group estimates that over the next decade the nonprofit sector will need 640,000 new senior managers. A large workforce population of retiring baby boomers can hardly be offset by the "baby bust" or even the "baby echo" generations, suggesting imminent and widespread worker shortages. Segments of the economy that are growing the fastest and have the greatest number of new openings, such as the nonprofit sector, will likely suffer the most shortages (Johnson, 2009).

But some say that there are flaws in the prediction of a nonprofit leadership crisis. "Reasonable – and likely-market and organizational adjustments, including higher executive pay, increased labor force participation of older workers, skill acquisition of younger workers, possible consolidation of nonprofit organizations, board and volunteer skill sharing, and event venture philanthropy, can be expected to moderate the shock of baby boom retirements, much in the way that schools, job markets, and housing markets have accommodated the movement of this "bulging" generation through earlier decades of their lives" (Johnson, 2009).

While studies show that young nonprofit workers are reluctant to fill top-level jobs in the sector (Solomon and Sandahl, 2007), Shelton and Shelton's (2005) study suggests that job characteristics of the nonprofit sector may lure experienced managers, especially Gen X employees, from other sectors. In a ranking of fifteen job characteristics in order of importance, (Fortune Magazine's "100 Best Companies to Work For), positive relationships with colleagues, interesting work, and continuous opportunities for learning ranked highest, while recognition/prestige and salary ranked very low. Highly rated companies were supportive of a balanced life outside work and an egalitarian environment. A number of studies (Leete, 2006) indicate that work in the nonprofit sector is perceived as more varied and challenging, and as providing more opportunities for skill development and autonomy, than in the for profit sector. Nonprofit sector work characteristics and benefits such as small organization size, passion for the mission, family sensitive-benefits and pay policies, flat organizational structure and flextime seem also to be advantages that would be attractive to the next generation of nonprofit managers coming from other sectors (Johnson, 2009).

Highlighting attractive characteristics of the nonprofit sector is not the only answer to the leadership deficit question. Insight arises from the social entrepreneurship movement, introduced in the 1960's and 70's, which came into widespread use in the 80's and 90's. "The main aim of a social entrepreneur as well as social enterprise is to further social and environmental goals for a good cause" (http://en.wikipedia.org/wiki/Social_entrepreneurship).

Although social entrepreneurs often work through nonprofits and citizen groups, the assessment of success can be done in terms of the impact on society as well as in profit and return. Running a nonprofit program or organization is much more like running a small business than it is like being a professional in a large corporation (Masaoka, 2009). Flexibility, connection with a variety of stakeholders, learning and mastery of new skills, and teamwork are required in both sectors because of the sizes of the organizations and the scarcity of resources. One of the demographic groups who share these characteristics is the millennial generation, those born after 1981. (Interchange Group, 2006).

This generation, who want a chance to do work that will benefit society, matches well with the goals of the social entrepreneurship movement (Interchange Group, 2006). Used to team-based learning and volunteer requirements at school, members of this generation are looking to grassroots activism to solve the world's problems as they mature.

Another demographic group, Generation X, born between 1962 and 1981, grew up during the time of the energy crisis, Watergate, and corporate downsizing. Called "latchkey kids," they survived the onslaught of tripled divorce rates, late working and dual income parents, economic

recessions, hiring freezes, and market crashes. Resilient under pressure, distrustful of hierarchies and sometimes institutions, and valuing autonomy, they are making different career choices which balance work and life. (Interchange-Group, 2006). Resiliency, autonomy, and work life balance are also valued in the nonprofit sector culture.

In the world of civic engagement (defined as organizational activity, volunteering, and fundraising), Gen Xers and Milenniums (also called DotNet's) are among the most active (Keeter, et al, 2002.) Civic engagement activities include participating in a walk, run, or bicycle ride for charity; participating in other activities to raise money for charitable causes; working in one's community to solve a problem; and doing volunteer work for non-electoral groups on a regular basis.

Community involvement is the foundation of civic engagement. Responding positively to the statement, "Worked together informally with someone or some group to solve a problem in the community where you live," sends a message of community engagement. Young people are often very mobile and less likely to own their own homes, suggesting that they might have fewer reasons to be invested in their communities Yet, 22 percent of Xers and 21 percent of DotNets have worked in their communities in the last year, quite similar to the more community invested Baby Boomers with 24 percent (Keeter, et al, 2002).

The challenge is to initiate a "leadership pipeline" that encourages the "next generation leadership" (or generations) toward preparation for social entrepreneurship, leadership, and employment in the nonprofit sector. (Cornelius, et al, 2008, p.5) Based on young people's volunteerism rates and interest in helping others, the time seems ripe for accomplishing this through college student involvement.

Although volunteerism rates have increased for most age groups, (an increase in overall volunteerism from 20.4 percent in 1989, to 26.7 percent in 2006), the volunteer rates of young people, age 16 to 19 (now 19 to 22) almost doubled. (Lester, 2007). Calling these young people, the "9/11 generation," David Eisner (Chief Executive Officer of the Corporation for National and Community Service) explains, "They came of age during 9/11. They learned new habits of responsibility, new habits of volunteering and those have stuck." According to the Higher Education Research Institute (2008), the percentage of beginning college students who believe it is very important to help others in difficulty reached a 25-year high in 2005.

The purpose of this paper is to introduce a unique elective course (Selected Topics-Management: Managing in the Nonprofit Sector) in the Master of Business Administration (MBA) program, that brings together experiential education and service (Dewey, 1938; Kolb, 1984) aspects of live case analysis of nonprofits while introducing potential nonprofit leaders and social entrepreneurs to this sector. Details of the course, ties to university and college outcomes, the community partners, projects, and student responsibilities; and course outcomes and challenges will be discussed in the following sections.

## Course Details

Selected Topics- Management: Managing in the Nonprofit Sector (The Managing Nonprofits course or MNC) is an introductory, albeit accelerated, survey of management in the nonprofit sector. Managing Nonprofits is a one-credit, five-week, elective course, which includes readings, discussion, guest speakers and a service-learning experience with a nonprofit organization. Service-learning is a course experience that uses community projects to reinforce class learning materials (Sigmon, 1994).

The Managing Nonprofits course (MNC) is one of the single-credit elective courses of a three credit elective series offered each semester. The other electives vary from Ethics in Managing Business/Government Relations, to Technology Entrepreneurship, to an Innovation Laboratory, among others.

MNC is the second fully integrated (service is required of all students) College of Business & Economics course, and the first fully integrated (service learning is required) MBA course in the College of Business & Economics at this university in the Northwestern United States.

The topics covered range from the management staffing and recruitment crisis in the nonprofit sector, standards of excellence and how to measure them, organizational culture, challenges that executive directors face, and managing the board and volunteers. Specific MBA program objectives include enhancing student personal growth in critical thinking, problem solving, and ethical decision making; and strengthening student interaction skills in presentations, and verbal and written communication.

The integrated Service-Learning component of the course focuses on the following objectives: 1) To develop a spirit of partnership with the community, and to solve problems in the real world through individual and/or group projects designed to benefit both the learner and the local community; 2) To encourage a life-long commitment to service and civic involvement; and 3) To explore how to integrate personal ethical and citizenship ideals with a successful management career. Underlying these umbrella objectives are goals to encourage interest in social entrepreneurship, to provide strategic assistance to executive directors, to provide a designated number of hours of pure service (as opposed to consulting), and to increase awareness of leadership opportunities in this sector.

## Ties to University Strategies and Goals

These service-learning component objectives tie in very closely to the University's strategic vision of public engagement (Charting the Course: A Strategic Vision for XX University) that links the academic mission with its community partners to address issues of mutual benefit. "Milestones" to reaching this "destination" are facilitating partnerships that contribute to regional growth and development and serving as a center for cultural and intellectual exchange that enriches the community.

## Course Requirements

MBA students complete five hours of service, conduct a two hour interview with the Executive Director (ED) about strategic issues, conduct an environmental analysis and evaluation of several local nonprofit organizations as a team, and write and present a report of recommendations for the nonprofit to the class, instructor, and Executive Director.

The instructor's criteria for the five hours service (separate from the two hour interview with the ED) is "anything that will assist the community partner, allows the student to experience the organization on site with minimal training (because of the short timeframe), and keep the student safe." The hope is that the agencies will meet with the student(s) to learn about their interests and abilities, and that a mutually satisfying arrangement will be made to use the student's talents and accomplish something (or things) worthwhile for the agency. Service has ranged from assisting with the design of a computer accounting system, to rewriting the mission statement, to researching the implications of several nonprofits sharing a building and resources, to writing policy manuals, among other responsibilities.

The two hour interview of the ED is enjoyed by both by the Ed and the students, and is done in week four, at the end of the service learning experience. The EDs have expressed their satisfaction with the interview, saying "that's the best part!" They relish the idea of discussing strategic issues, and hearing feedback from business managers. The "external" wisdom seems most gratifying. While they talk well of the quality and productivity of their staff and boards, they also seem to recognize that an outside view from technical professionals is valuable. Because of their business-savvy, volunteers with business background help nonprofits do more with less (Scott, 2009).

In conjunction with their interviews, the students complete an "Environmental Analysis, Evaluation, and Recommendation Paper and Presentation." In addition to a SWOT analysis, students analyze the mission and whether the organization is meeting it, define and measure operational challenges, describe and evaluate funding sources, and critique the relationship of the Board and senior management. The paper also reflects on what was learned from this experience in terms of the student's role as a professional and as a member of the community.

## Community Partners

Community partners were selected from a subset of nonprofits that the instructor had worked with in previous service-learning projects and courses, and recommendations from the University Service Learning community liaison program. Primarily small human services organizations, both direct service and advocacy groups, were used. Selection for the MBA class was based on the likelihood that the agency could provide projects with a higher level of rigor for the MBA students. The instructor met with each ED at the site prior to the semester start, to discuss the objectives of the course, and how they fit in with the needs of the community partner organization. Emphasis was put on the requirement that the student will work directly with the ED on strategic issues, rather than the student working with a volunteer coordinator or another manager. The type of assignments, and the idea that most MBA students have both classroom and outside experience, appealed to the ED's. The ED was invited to join the class on the first night to give a presentation about the organization and its needs, and meet with the students, and on the last night to hear the student presentations and critique the viability of their recommendations. Most EDs attended both sessions, often bringing other staff members to the closing presentation.

## Outcomes-students, community partners, professor

This course is one that I am especially proud to be a part of, as it probably, more than any other course I've taught, achieves an almost universal positive learning response from students (as supported by course evaluations and anecdotal evidence.) As is the point of experiential learning, the exposure to the live case helps the students to apply and better understand the course content.

Anecdotal evidence and standard course evaluations suggest that students gain a solid understanding of the nonprofit sector, and often plan to continue service after the class. The Service Learning Program also provides site and course evaluations which are completed by the students and the host organizations. These also support the mutual benefit derived by the student and community partners. Examples of outcomes from the qualitative data follow:

> *"I really enjoyed the class…This was one of the few classes that I could take my learnings outside of the class and really apply it to an organization that really needed my help. So often, I hear professors telling us that we are going to use the knowledge learned from a course later in our career, but this allowed us to do it now."* – D.O. MBA student

> *The premise of the course was to introduce graduate level students to nonprofit organizational composition. The course was both beneficial and inspiring. While the curriculum was beneficial, the most moving piece of the course was the actual field work we were required to complete.* G.T. – MBA student.

One student was so moved by the "selfless motivation that drove the group's employees and volunteers," that he was compelled to take further action. As described in the following testimonial, this resulted in a cross-sector alliance between his employer and his service learning host which remains in place several years later.

> *"My time there compelled me to take action. Our firm is now partnered with (the community partner). We are scheduled to provide …training in all of the most contemporary preparation, merchandising, and service practices. Further, we have created a strategic alliance so that graduates of the program have an alternative for employment after graduation. We have also committed to make financial contributions where we can. In short, my requirement became an experience which became a piece of my firm's corporate mission. While my motivations to take this course surrounded the professor, I am thankful I elected to take this course as it will deliver value to my firm and the community."* G.T. MBA Student

Quantitative reports from student evaluations of the service learning component were compiled by the Service-Learning Program. Scores more than 60% positive were interpreted to show that the instructor was effectively employing service learning pedagogy and active learning strategies. Scores for this MBA course averaged 70 to 99% depending on the question.

The following are examples of the evaluation questions:

1. This class helped me become more interested in helping solve community problems.
2. Structured reflection activities (e.g. journals, reflection sessions) helped me analyze issues about citizenship or my responsibility in the community.
3. Service-learning helped me see how course concepts can be applied to everyday life.
4. Through service-learning I gained practical experience that will appeal to employers, graduate school, and/or scholarship reviewers."

Evidenced by their attendance and reactions at the final class presentations, the Community Partners' quantitative evaluations of student performance (managed online by the Service Learning Program), and the following comments from emails to the instructor and from the actual online evaluations from the community partners, it appeared that they were pleased with the impact the student service made on their organizations.

> *"The board has really stepped up since your students SWOT analysis and criteria and honest feedback. I also have made an effort to be a better leader and I think it is working."* –Executive Director

> *"But I wanted you to know that she stated to me that this was the most Positive SL (service learning) experience yet for (Community Partner). Your students were delightful, thorough, bright, and all demonstrated expert knowledge. They all helped with various segments of the (Community Partner) operations but also rewrote mission statement and demonstrated to (Executive Director) a clear understanding of the work that (Community Partner) does.* – email from the university Coordinator for Community Partnerships about the conversation with the Agencies' Executive Director

> *"(Student) was also a great match for this project. Like the others very motivated and invested. They all also were very creative I believe in problem solving and marketing. (student) was also able to go to a (location) which I believe is the purest form of what (organization) is all about. (Student) was great. I was overall very happy with this project and all the students. They worked well individually and as a group. I also just want to assure you that this experience will impact the future of the organization.* -Executive Director

In the evaluations of three team members for a warehousing operation, the Executive Director reflected positively on how each student brought skills (auditing, transportation, and merchandising) from his business background to improve the agency.
Most visible of the outcomes achieved is the students' awareness of their part in the community (we are the community.") It is a bit of an "aha" moment for some of the students, who have perhaps been aware that charitable organizations exist, but have never considered these organizations' relationship to the student, student's family, friends, neighbors, and employers. Other students may have been involved in church and other organizations as part of family tradition, or elementary or high school club service requirements, but have partitioned this off from other parts of their lives, often as something to do "..maybe when I'm done with classes and have more time."

Improved communication, problem solving, and critical thinking skills are key outcomes sought and assessed by our College and University. Students become immersed in opportunities to enhance these skills in their discussions and organizing with both management and other service learning students and volunteers at the sites. Public speaking and time management skills are improved with agency experiences (some students met and presented to organization boards, for example) and with formal and informal class discussions and presentations.

The diversity of the organizations represented in class, the reflection sessions, and the application of management and leadership principles to these organizations in small and large group discussions made powerful impressions on the students and intensified their desire to contribute and be a stakeholder in the community (Lamb, Lee, Swinth, & Vinton, 2000).

## Challenges

Because the course is a 5-week, one credit class, it is a quick turnaround from week one to five. Meeting the community partners, serving, interviewing, and writing and presenting the paper is a "blur" and may detract from the possible richness one could enjoy if the course were longer. Several students have inquired about making the course three credits, over the course of the full semester.

Another possibility is to reconfigure the current elective Service-Learning component and its objectives to a required management course, where civic engagement would become a core component of the MBA program, rather than an elective. Other options are to encourage nonprofit and College of Business and Economics partnerships in other ways: for example, students applying and serving as volunteers or board members; or live case projects that assist nonprofits in accomplishing goals they've established through Standards of Excellence training (Standards for Excellence: An ethics and Accountability Code for the Nonprofit Sector, 2005.) Future research could be focused on empirical studies. One study might compare the learning outcomes of students taking the course with the service learning component to those without the service learning component. Longitudinal studies of students' post-graduation and several years into their careers would be interesting to compare from the perspective of quantifying the number of individuals who actually participate in some way in the nonprofit sector (social entrepreneurs, executive directors, board members, volunteers, managerial and non-managerial employees).

The service learning component in this MBA special issues course appears to have satisfied objectives for several stakeholders. The students have an awareness and respect for the needs of the community, enhanced communication, team and problem solving skills, and secured content knowledge on the nonprofit sector. The Executive Director and nonprofit sector have had the benefit of experienced business professionals examining problems in their organizations, and an opportunity to introduce college students to a nonprofit and encourage future involvement of these individuals, as managers, executive directors, or social entrepreneurs, in the sector.

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# EVALUATING THE IMPACT OF FEDERAL LEGISLATION ON SMALL BUSINESSES: AN EXPLORATORY STUDY OF THE NEW MINIMUM WAGE RATE AND THE PROPOSED HEALTH INSURANCE TAX

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## Abstract

This research provides a discursive assessment of the impact of the federal legislation with regard to minimum wage and the proposed health insurance surcharge on small businesses with $250,000 in labor costs that do not carry health insurance for their employees. We employ a case method to evaluate the financial impact of federal legislation on a single firm in the restaurant industry. The minimum wage affect will be experienced by all of the firms in our examples while both of these changes will only have a financial impact on small businesses with greater than approximately 10 - 16 employees, depending upon the mix of full-time and part-time employees. We conclude that a firm with as few as 20 employees may have as much as a 50-55% decrease in net income as a result of the two federal labor laws discussed in this research. We also discuss the options available to these firms as well as provide suggestions for future research on these issues.

## Introduction

External laws and regulations can make a serious impact on small business performance (Robinson, et al, 1998). While wage rates and the taxes on those wages affect the total labor costs incurred by all businesses, small firms are especially challenged by changes in their labor costs because the burden is often not shared by multiple shareholders, but rather by a sole proprietor or a few shareholders in a closely held firm. On July 24, 2009, the national minimum wage will increase by $0.70 per hour for all employees. In addition, Congress is proposing new health insurance legislation that will charge an eight percent premium to businesses with total labor costs exceeding $250,000 to small businesses that do not provide health insurance for their employees.

The purpose of this paper will be to assess the possible impact these two issues will have on small businesses. These issues are not trivial. They can be especially significant to entrepreneurs and small business owners for four reasons. First, small businesses represent 99.7% of all employers in the U.S. (Small Business Administration, 2009a). Second, the U.S. Small Business Administration states that the vast majority of firms have fewer than fifty employees (Small Business Administration, 2009a). Third, small businesses generally do not have human resource expertise in place to manage the impact of such changes. Fourth, an increase in labor costs will have a direct impact on the net income of a small business, many of which are operated as sole proprietorships or closely owned business entities.

## Background Literature

Numerous articles advise a small business owner about how to handle everything from AIDS in the workplace (Franklin and Gresham, 1992; Hoffman and Clinebell, 2000) to sexual harassment (Robinson, et. al. 1998) and taxes. Compliance with tax regulations, environmental regulations, employment regulations, accessibility regulations, industrial and safety regulations, and the impact of federal laws on business are just a few of the myriad of legal topics addressed by the

literature. When examining industry-specific topics, the review of specialized standards for performance and operations, quality and control, and industry-wide guidelines may also be determinative of how a firm channels it legal resources. Other opportunities for detailed review of legal concerns include the ownership of land and facilities and the impact of the locality on zoning and planning regulations that affect the business.

Nonetheless, both the human resource literature and the small business literature is largely mute about minimum wage and the proposed new health insurance tax on small businesses with $250,000 in labor costs that do not carry health insurance for their employees. Of course, these two issues are literally new topics for analysis and discussion. The new minimum wage rate went into affect on July 24, 2009. The proposed tax for small businesses without health insurance will not occur for approximately 12-18 months depending upon what bill actually makes it from Congress to the President.

In the next section we discuss both the minimum wage and the proposed new health insurance tax on labor costs above $250,000. Then, we demonstrate the impact of these two increases in labor costs on both the employer's and the employee's perspective using financial analysis. Next, we address the potential management response a small business may have to these two changes. Finally, we suggest possible directions for future research.

*Minimum Wage*

In 1938, the Fair Labor standards act was passed, which was a sweeping piece of employment-related legislation. One provision of this act was the creation of a "minimum wage". This wage was originally set at $0.25 an hour. Over the years, the U.S. government has increased this amount, most recently from $6.55 an hour to $7.25 an hour, the third consecutive annual increase. As recently as June 30th, 2007 the minimum wage was $5.15 an hour. On July 1, 2007, it was increased to $5.85 an hour, a 13.6% increase. The following year, it was increased to $6.55, a 12% increase and then most recently to $7.25, and increase of 10.7%. The total jump of $2.10 an hour over the 2 year period is a 40.8% increase in minimum wages (US DOL, 2009). Such a large increase in minimum wage sparks concerns about the potential to decrease demand for minimum wage labor, particularly in an environment of rising unemployment and economic distress. Several recent analyses of the relationship between minimum wage rates and unemployment find a positive relationship between minimum wage rates and unemployment, particularly among small businesses, retail employment and most strikingly among teenage workers, the largest pool of minimum wage workers (Neumark and Wascher, 2009; and Sabia, 2006). A 2009 study by David Neumark of the National Bureau of Economic Research and William Wascher, a member of the Board of Governors of the Federal Reserve System - Division of Research and Statistics, reviewed the past studies examining minimum wage and unemployment and found that increases in minimum wages consistently caused declines in employment, particularly among the least skilled workers. A 2006 Study by Joseph Sabia sheds further light on this relationship. His study, which looked specifically at employment in the retail and small business sectors, found that increases in minimum wage fairly consistently related to decreases in employment in those sectors. Specifically, he found that a 10% increase in minimum wage translated to approximately a 1% decline in employment in the retail and small business sectors. Using his numbers, the recent 40% increase in US minimum wage would be expected to have a 4% disemployment effect on workers in retail and small businesses. He also

found that this effect was amplified for low skill employees, particularly the teen workers most affected by such a change. Specifically he found "A 10 percent increase in the minimum wage is associated with a 2.7 to 4.3 percent decline in teen employment in the retail sector, a 5 percent decline in average retail hours worked by all teenagers, and a 2.8 percent decline in retail hours worked by teenagers who remain employed in retail jobs." This would explain recent reports that place the unemployment rate for black teenage males at an 50% and the rate for white teenage males at 26.5% (Bartlett, 2009). Furthermore, Bartlett cites Bureau of Labor Statistics data that indicate that "Well over half of those paid at the minimum wage are under the age of 24 and two-thirds of them are teenagers. Almost 60% work part-time and more than half work in food preparation and serving-related occupations. Minimum wage workers are not well educated. About 40% don't have a high school diploma, and a third have only a high school education. Just 3% of those working at the minimum wage have graduated from college." He also points out that among the US workforce of 155 million, only 95 thousand work full time at minimum wage in 2008. In short, the impact of the minimum wage increase was largely upon part-time, teenaged workers, not the elusive starving family surviving on minimum wage.

*Health Insurance*

Before we can understand the implications of health insurance for small businesses, we must first understand the health care system in the U.S. In a monograph prepared by Louis Rossiter, he makes the following statement, based upon his analysis of the place healthcare has within our overall economy:

> *The basic problem is not simply that we are spending more on healthcare in terms of how much we use and the price of that care. The problem is the accelerated rate of the increase when compared to other components of the economy. As each year passes, healthcare consumes an ever-larger share of expenditures, increasing from 9.4 percent in 1981 to 16 percent in 2006. Today, that figure is higher* (Rossiter), 2009, p. 4).

Health insurance among small businesses is clearly an important issue. According to a research study by the National Federation of Independent Businesses (NFIB), the rising costs of health insurance are the number one problem faced by small business owners. Their study of 3,530 small business owners in 2008 identified problems and priorities the business owners believed to be the most critical to them from among a list of 75 potential items. Health insurance was identified as the number one small business problem for the 20th consecutive year that this series of research studies has been conducted. The magnitude of this particular problem is quite alarming. Fifty six percent of the respondents of this study indicated it was a "critical' problem while the second most cited problem, "Energy Costs, Except Electricity," was rated critical by only fourteen percent of the respondents.

The issue of health insurance has reached extreme levels according to some studies. According to research conducted annually by the Henry J. Kaiser Family Foundation between 1999 – 2009, the percentage of firms offering health benefits has declined from 69% in 2000 to 59% in 2009 (Kaiser/ HRET, 2009). As one might expect, their research also found "The smallest firms are least likely to offer health insurance. Only forty-six percent of firms with 3 to 9 workers offer coverage, compared to 72% of firms with 10 to 24 workers, 87% of firms with 25 to 49 workers (Exhibit 2.3) [Exhibit number in the study], and over 95% of firms with 50 or more employees"

(Kaiser/ HRET, 2009, p. 34). Figure 1 shows the data from the 2009 Kaiser/HRET study. Costs were cited as the primary reason in the 2009 Kaiser/ HRET survey by 41% of the firms that did not offer health insurance.

Figure 1. Percentage of Firms Offering Health Benefits, by Firm Size, 1999 – 2009

| Firm Size (Workers) | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 3 – 9 | 56% | 57% | 58% | 58% | 58% | 52% | 47% | 48% | 45% | 49% | 46% |
| 10 – 24 | 74 | 80 | 77 | 70* | 76 | 74 | 72 | 73 | 76 | 78 | 72 |
| 25 – 49 | 86 | 91 | 90 | 86 | 84 | 87 | 87 | 87 | 83 | 90* | 87 |
| 50 – 199 | 97 | 97 | 96 | 95 | 95 | 92 | 93 | 92 | 94 | 94 | 95 |
| All Small Firms (3 – 199) | 65% | 68% | 68% | 66% | 65% | 63% | 59% | 60% | 59% | 62% | 59% |
| All Large Firms (200 or more) | 99% | 99% | 99% | 99% | 98% | 99% | 98% | 98% | 99% | 99% | 99% |
| ALL FIRMS | 66% | 69% | 68% | 66% | 66% | 63% | 60% | 61% | 60% | 63% | 60% |

* Estimate is statistically different from estimate for the previous year shown ($p<.05$).
Source: Kaiser/HRET Survey of Employer-Sponsored Health Benefits, 1999 - 2009

The academic literature on health insurance and small businesses is limited at best. Some of the topics in the literature include studies that confirm the extent of health insurance coverage among small firms (Robinson, 2008), recommendations regarding managed care (Bradley and Hobbs, 2008), the perceptions of small business owners of the cost of health insurance, and several studies about the costs of health insurance (Robinson, 2008; Opiela, 2008). This last issue is the primary topic in the academic literature when health insurance has been covered. These studies reach the same conclusion: the cost of health insurance is prohibitive for small firms (Opiela, 2008; Kathawal, Elmuti & Roszkowski, 1993; and Morrisey, 2003). Small firms are simply not able to negotiate health insurance contracts (Cebula, Gubenko, & McGrath, 2007). Benoit points out that rising health care costs explains why employers are "choosing looser managed care products in response to the managed care backlash…" (Benoit et al., 2007, p. 66). In a Government Accounting Office (GAO) study, Allen (2001) finds that small firms tended to have higher average cost-sharing requirements and did not offer certain benefits such as psychiatric and chiropractic coverage (Allen, 2001). Yet, it is hard to gauge the magnitude of health insurance costs in small firms because the literature provides absolute values among a sample of firms (see, for example, Kaiser/ HRET, 2009). Survey research has been used previously, but it has not captured the relative magnitude of health insurance, especially relative to other expenses of a profitably operating small business. Thus, before public policy on health insurance can be properly enacted, government policy makers must understand the relative magnitude of these costs. It is this gap in the extant literature that we address in this study.

## Research Method

This study employs a modified case study to evaluate the affect of the new minimum wage standard and proposed health insurance tax on small firms  The challenge challenge of conducting research about these two subjects and small businesses is that the literature on either subject is rather limited.  Thus, a more traditional empirical study would not be appropriate.  The emphasis in this study is on the affects of the new minimum wage and health insurance tax at the firm level which does not lend itself to survey methodology.  Hence, we employed a more exploratory stage of research (Gorman and Hanlon, 1997).  In such a situation, it is appropriate to use a qualitative research method in order to gather the necessary information (Eisenhardt, 1989; Yin, 1994).  The current research necessitated that we observe the affects of the new minimum wage standard and the proposed health insurance tax on the financial performance of a single small business.  Thus, we adopted a qualitative research method described by Audet and d'Amboise (1998) in their study which was broad-minded and flexible.  Like their study, our aim was "to combine rigor, flexibility and structure without unduly restricting our research endeavor" (Audet and d'Amboise, 1998, p. 11 of 24).

In order to focus on the financial impact at the firm level, we first look at minimum wage and health insurance for firms ranging in employment size of five or fewer employees to firms with as many as forty employees.  These numbers of employees are consistent with what we know from the Kaiser/ HRET series of studies.  Next, we use the financial statement from a single firm with a high percentage of minimum wage workers to assess the impact of the new minimum wage rate, with adjustments for firm size.  Finally, we summarize these affects to gain a perspective on the overall impact of the new minimum wage standard and proposed health insurance tax on the financial performance of a small business.

*Labor Costs*

We evaluate the cost of raising the minimum wage rate to $7.25 for small businesses based upon sizes of 5 employees, 10 employees, 20 employees, and 40 employees.  Our evaluation holds other factors constant.  Table 1 shows our findings.

Since many minimum wage earners work part-time (DOL, 2009a), which can vary from 1 – 34 hours (DOL, 2009b), we used 25 hours as a base number of hours.

Table 1. Impact of New Minimum Wage Rate on Payroll Costs

| | 5 employees | 10 employees | 20 employees | 40 employees |
|---|---|---|---|---|
| 25 hours per week x 50 | 1250 | 1250 | 1250 | 1250 |
| Number of Employees | 5 | 10 | 20 | 40 |
| FICA, Medicare | .0765 | .0765 | .0765 | .0765 |
| Increase in Minimum Wage | $0.70 | $0.70 | $0.70 | $0.70 |
| | | | | |
| Total Payroll Increase | $4,709.69 | $9,419.38 | $18,838,75 | $37,677.50 |

*Health Insurance Tax Costs*

The proposed bill will charge small businesses with total labor costs exceeding $250,000 and do not provide employee health insurance a tax or penalty of 8%. A recent article in the Wall Street Journal points out that, "according to 2006 data from the federation, businesses with between five and nine workers, representing about one million employers, had an average payroll of around $375,000 a year. A report from the Kaiser Family Foundation found that only about half of firms with three to nine workers offered health benefits in 2008" (Adamy and Meckler, 2009, p. A1). It is not our intent to debate the merits of this legislation, but rather to evaluate the financial impact this legislation may have. As the literature review points out, this aspect of discussions of health insurance for small business employees is very new. More importantly, the literature that does address health insurance focuses on a macro-economic perspective. We choose to consider the implications of this proposed legislation on the financial performance of a typical small business. Table 2 shows our calculations for firms differing in size by employment, starting at 5 employees and increasing to 10 employees, 20 employees, and lastly, to 40 employees. Each of these levels of employment are considered below the standard used to categorize a company as either large or small in the United States (Small Business Administration, 2009b).

Table 2. Impact of Proposed Medical Insurance Tax on Payroll Costs

| | 5 employees | 10 employees | 20 employees | 40 employees |
|---|---|---|---|---|
| 25 hours per week x 50 | 1250 | 1250 | 1250 | 1250 |
| Number of Employees | 5 | 10 | 20 | 40 |
| FICA, Medicare | .0765 | .0765 | .0765 | .0765 |
| Minimum Wage | $7.25 | $7.25 | $7.25 | $7.25 |
| Total Payroll | $48,778.91 | $97,557.81 | $195,115.63 | $309,231.25 |
| 8% Medical Insurance | n/a | n/a | n/a | 0.08 |
| Total Medical Insurance | n/a | n/a | n/a | $31,218.50 |
| Impact | | | | |
| | | | | |
| Total Change in Labor Costs | $8,612.00 | $17,224.00 | $34,448.00 | $68,896.00 |

The medical insurance penalty (tax) will only affect companies with payrolls that exceed $250,000 in the current proposals before both houses of Congress. Reaching the threshold of $250,000 depends on the total number of employees, the mix of full- and part-time and their respective hourly wages or salaries. If a firm with 20 employees has 10 full-time workers and 10 part-time employees (25 hours per week), then they will have employee payroll of over $250,000. However, we use a conservative estimate of hours per week and number part-time workers.

Table 3. Impact on Total Payroll Costs

| | 5 employees | 10 employees | 20 employees | 40 employees |
|---|---|---|---|---|
| Total Payroll Increase | $4,709.69 | $9,419.38 | $18,838.75 | $37,677.50 |
| Total Medical Insurance | n/a | n/a | n/a | $31,218.50 |
| | | | | |
| Total Change in Labor Costs | $4,709.69 | $9,419.38 | $18,838.75 | $68,896.00 |

*Total Change in Costs to the Small Business*

To this point, our analysis has separately addressed the impact of the new minimum wage rate and the proposed health insurance tax. We now combine these two analyses to determine the total change in payroll costs to the small business. For this study we selected a relatively small, publicly traded, food service business. Food service businesses commonly employ a high percentage of part-time, minimum wage employees (DOL, 2009). Buffalo Wild Wings, Inc. went public in 2003, operates 197 restaurants and has 363 franchise units. The company has 12,000 employees; 1,000 full-time, 10,800 part-time and 200 employees based in the home office or field support management positions. Assuming all part-time employees work in the restaurant operations, there are approximately 55 part-time employees per restaurant.

Table 4. Total Labor Costs with both Full and Part-time Employees

| | Part-Time | Full-Time |
|---|---|---|
| Part-Time Labor 25 hrs / week @$7.25/hr | 8 | 26 |
| Full-Time Labor @ 40 hrs/ week @ $10.00/hr | 8 | 0 |
| Total Number of Employees | 16 | 26 |
| Total Payroll including FICA** | $250,286.25 | $253,650.31 |

** A firm with as few as ten full-time employees earning $12.50 per hour would have a total payroll of $ 269,125, including FICA and Medicare.

We wanted to analyze the effects of the current change in minimum wage and proposed health insurance tax on a single restaurant. The consolidated financial statement numbers were divided by 197 restaurants to approximate the earnings of a single restaurant. Ideally the franchise royalties and fees and related general and administrative costs and expenses would have been eliminated from the analysis to better isolate the restaurant activity. The franchise royalties and fees are easily identifiable; however, the portion of general and administrative costs and expenses related to the royalties cannot be determined from the information provided in the corporation's 10-K report. Therefore, we did not eliminate the revenue or the related expenses from the analysis.

As noted, part-time employment is defined as working between 1 and 34 hours per week. For this analysis we used 25 hours per week as the average part-time employment. In order to estimate the effect of the increase in minimum wage, we used 25 hours, 55 employees, for 50 weeks, times the seventy cent increase in minimum wage, plus the increase in social security tax on this incremental increase at the 7.65% rate. The effect of the eight percent insurance increase was computed on the total estimated part-time payroll using the new minimum wage. Buffalo Wild Wings is currently self-insured. We applied the eight percent increase in labor costs only to the part-time employment because the originally reported earnings statement would have included an insurance cost for full-time employees.

The results reveal that the effects of the minimum wage and insurance tax are not immaterial. The combination of these two changes decreases net income by approximately one-half. Net income decreases from 5.3% to 2.4%. When comparing the return on investment from running this successful restaurant to the return from investing in a treasury bond, the restaurant becomes even less appealing.

Taking the analysis for the change in the unemployment rate and the proposed health insurance tax into account we gain an appreciation for the total change in costs to the small business. We used the financial statements of the Buffalo Wild Wings, Inc. restaurant chain for this step. We chose this restaurant for two reasons. First, the Department of Labor maintains records of employment across all sectors of the economy. The restaurant industry has the highest percentage of workers that are paid minimum wage. Thus, a firm in this industry serves as a reasonable basis for analysis of changes in minimum wage. Secondly, we were reasonably confident in the reliability and external validity of Buffalo Wild Wings, Inc.'s financial statements. A perusal of *Yahoo!® Finance* provided a list of sixty-two companies in the restaurant industry with summary financial ratios for each of them which included Buffalo Wild Wings, Inc. Their profit margin of 5.3% was similar to the 7.7% profit margin for all firms in the Yahoo! Finance database.

## Discussion

This study employed a modified case study method to evaluate the impact of the the new minimum wage standard and proposed health insurance tax on the financial performance of a small business. Previous research focused attention on the macro-economic impact changes in minimum wage have on the American economy. Similarly, research on health insurance has focused on the absolute costs to the small firms or the macroeconomic impact changes to our system would have on the country. This study asked the simple question, "To what extent do these two factors affect the financial performance of a small business?" Our goal was to observe the relative magnitude of these factors on the financial performance of a single small business.

As part of our research design, we selected a relatively small, publicly traded, food service business. Food service businesses commonly employ a high percentage of part-time, minimum wage employees (DOL, 2009). In addition, depending upon employment figures, they may be impacted by the proposed health insurance legislation. Thirdly, this particular restaurant chain reported net earnings that were near the mean of a sample of 62 similar companies evaluated by Yahoo! Finance. The results of our financial analysis reveal that the effects of the minimum wage and insurance tax are material. The combination of these two changes decreases net income for a single franchisee restaurant by approximately one-half. Net income decreases from 5.3% to 2.4%.

## Conclusions and Implications

In this section we address the implications for theory and future research as well as the practical implications of our findings. It is clear that the change in the minimum wage rate as well as the proposed health insurance tax each has a profound impact on the financial performance of a typical restaurant. When both factors are taken into account, their impact is rather startling. In our example, the firm's profit margin falls by a factor of one-half from 5.3% to 2.4%.

Such a drastic change in the financial position of a company could not be ignored. Faced with such a drastic decline in profit margin, a small business owner has few options available to them. Some of these options are rather predictable, while other plausible options are less predictable. Thus, we consider how a small business owner may respond to increases in their cost of labor due to the new minimum wage rate and/or the proposed health insurance tax.

One option available to the owner is rather predictable. According to studies by Morrow, Johnson, and Busenitz (2004) and Pearce and Robbins (1994), the typical response by companies faced by this type of situation is to seek cost-cutting measures, which typically include layoffs. Thus, one possible outcome is that small firms faced with increases in minimum wage and health insurance penalties would layoff employees. In fact, the literature on minimum wage earners points out an increase in the minimum wage has a negative employment effect among teenagers and low-skilled workers (Neumark and Wascher, 2007). It remains an empirical question whether small firms would layoff workers

A second option we might label "1B" as a small business may layoff workers solely due to the health insurance penalty. While the minimum wage law may not raise wages on their existing employees, the new health insurance penalty may impact a firm. Table 4 shows how few full-time workers are required for a firm to reach $250,000 in annual payroll costs. Consider a firm with payroll of $250,286.25 as shown in Table 4, based upon a mix of eight full-time employees and eight part-time employees. Congress is still debating the fine details of the proposed legislation, but cutting hours for a worker or simply laying off an employee will lower payroll below the 'magical' threshold of the current legislation proposed in Congress.

Another variation of this option would be to manipulate the ownership of the organization. A closely held firm with multiple locations could simply spin off the locations as separate companies. So long as a holding company is not involved this option may be rather novel, effective yet unethical.

A third option is the traditional human resources choice of capital vs. labor. In a situation of escalating labor costs, businesses frequently opt for the choice of buying machinery that makes labor unnecessary. Both the increase in the minimum wage and the proposed health insurance tax will raise the labor costs for many small businesses. In this case, the dual jeopardy introduced by an increase in the minimum wage accompanied by a forced insurance program is a significant enough change to the cost of labor to greatly impact the labor versus capital decision. Companies that were comfortable with a labor intensive manual process may be willing to invest in significant capital equipment that would have previously been cost prohibitive. As is always the case, a business owner must choose the option that provides the customer with the best product or service at the lowest cost. If it becomes cheaper to purchase a mechanized process to complete the product or service, companies will have no choice but to accede to the economic reality.

A fourth option a small business owner may make is to relocate their labor intensive processes outside the US. For the past several decades, US businesses have found themselves in the unfortunate and uncomfortable position of having to close US plants to relocate the manufacturing or services to a location in a low labor cost location. Locations such as China, India, Korea and Mexico are often chosen due to low labor costs (Longenecker, et al., 2008) and less restrictive legal requirements.

Mark Wilson (2009) argues that in response to an 8% health insurance penalty, some small firms may drop coverage for their employees. Why would they do so? Quite simply these small business owners would do so if the product of eight percent times their payroll expense is less than the amount they presently pay in premiums for the employee's health coverage. The Bureau of Labor Statistics reports that the average cost of health insurance to a business is 11.6 percent of wages and salaries which is clearly higher than the proposed tax of 8% (2009). The Congressional Budget Office (CBO, 2009) points out a flaw in this portion of the proposed legislation is that employees that have their employer-sponsored health insurance dropped would then have to look elsewhere for health insurance as the 8% penalty has not been directed to make a contribution to the employee's insurance costs.

A final option related to health insurance costs that may be considered by the small business owner has been addressed in previous studies discussed in this research. Allen (2001) pointed out that some small firms simply reduce the benefits to their employees as their portion of the insurance premium rises from year-to-year. Thus, the company would continue to offer health insurance to its employees, but the scope of that coverage would shrink. The employees would receive fewer services for what would most likely be a higher premium as health care costs rise (Rossiter, 2009; Kaiser/HRET, 2009).

We cannot say with certainty that a small firm will choose any of the aforementioned courses of action. Yet, any of these courses of action is plausible. Some of them, such as layoffs or reduced benefits for health insurance, have been identified in the literature. Thus, we can be relatively confident that some small businesses will choose those alternatives. In the event they do, then the very people these government policies are intended to benefit may very well be harmed.

The findings of this study demonstrate the possible unintended consequences of well intentioned government policies. The intent behind minimum wage is to provide a "decent" wage for working Americans. Similarly, the proposed health insurance legislation is noble because it attempts to address the gap (Rossiter, 2009) between the number of Americans that are insured versus those that are not. Most people would agree that one role of government is to care for its citizens. However, we demonstrate that several possible outcomes may occur, depending upon the individual choices small business owners make as minimum wage rates and health insurance tax evolve over the next several months, that are simply not beneficial for employees.

Small businesses frequently begin with little net income. The restaurant business in our study is small for a publicly traded business. The estimated effects of the increase in minimum wage and insurance tax cuts net income to just over two percent. As an investor exploring new business and investment possibilities, one must question whether this return is enough to encourage investment in small business. Investors can earn similar returns or better with a bond fund with little to no risk.

At the same time, banks have tightened credit lines and are less willing to lend money. So the increase in minimum wage and insurance tax may add to the credit crisis, by further decreasing the investment capital available for new startup businesses and small businesses.

More importantly, a decrease of net income to two percent may force drastic a reaction by the owner(s). Cost cutting measures will likely occur. These measures generally involve manipulation of labor costs (Morrow, Johnson, and Busenitz, 2004; Pearce and Robbins, 1994; and Allen, 2001) which would not bode well for the firm's employees.

The recent change in the minimum wage provides new opportunities to explore the relationship between a change in minimum wage and employment in the US that can further improve our understanding of this important issue. It represents a natural experiment that can contrast the impact in states without a state level minimum wage with states that have a state mandated minimum wage that is higher than the federal rate.

Yet, a macroeconomic view of national unemployment rates does not always provide the clearest perspective of this issue or other issues related to employment or changes in total labor costs. Joseph Stalin once said, *"A single death is a tragedy; a million deaths is a statistic."* We might paraphrase this logic as it applies to the plight of small businesses, *"The death of a single small business is a tragedy; the death of hundreds of thousands is a statistic."*

The impact of changes in minimum wage on employment is a statistic that affects many people. When observing or discussing these values in research studies (e.g., 6.2% unemployment rate), one can easily ignore the impact that an increase in labor costs has on a single small business, its owner, and its employees. Thus, it may be worthwhile for future research to focus attention on firm-specific financial performance issues as they relate to the minimum wage and the prospect of a health insurance tax on businesses with payrolls over $250,000 that do not insure their employees. Our research is an introductory effort to shed light on this critical topic. The options we suggested small business owners may choose in response to minimum wage and a health insurance lend themselves to simple hypothesis testing on a future sample of small firms should both issues materialize. They are clearly plausible alternatives to the small business owner that is concerned about rising labor costs, although researchers may want to identify other alternatives as well. It can be stated with relative certainty that most small business owners are not simply going to sit back idly while their labor costs go up without any real improvement in quality or productivity. The real question that remains is exactly what they will do. That is an empirical question that should be considered in future research.

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# Appendix I
# Buffalo Wild Wings, Inc. Form 10-K

**BUFFALO WILD WINGS, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF EARNINGS**
**Fiscal year ended December 28, 2008**

| | Consolidated December 28, 2008 | One store before change | | One store after change | |
|---|---|---|---|---|---|
| **Revenue**: | in thousands | adjusted for 1000s | Percent of Sales | adjusted for 1000s | Percent of Sales |
| Restaurant sales | 379,686 | $1,927,340 | 89.9% | $1,927,340 | 89.9% |
| Franchise royalties and fees | 42,731 | $216,909 | 10.1% | $216,909 | 10.1% |
| Total revenue | 422,417 | $2,144,249 | 100.0% | $2,144,249 | 100.0% |
| **Costs and expenses**: | | | | | |
| Restaurant operating costs: | | | | | |
| Cost of sales | 113,266 | $574,954 | 26.8% | $574,954 | 26.8% |
| Labor | 114,609 | $581,772 | 27.1% | $676,504 | 31.5% |
| Operating | 60,205 | $305,609 | 14.3% | $305,609 | 14.3% |
| Occupancy | 25,157 | $127,701 | 6.0% | $127,701 | 6.0% |
| Depreciation and amortization | 23,622 | $119,909 | 5.6% | $119,909 | 5.6% |
| General and administrative [(1)] | 40,151 | $203,812 | 9.5% | $203,812 | 9.5% |
| Preopening | 7,930 | $40,254 | 1.9% | $40,254 | 1.9% |
| Loss on asset disposals and impairment | 2,083 | $10,574 | 0.5% | $10,574 | 0.5% |
| Total costs and expenses | 387,023 | $1,964,584 | 91.6% | $2,059,316 | 96.0% |
| Income from operations | 35,394 | $179,665 | 8.4% | $84,933 | 4.0% |
| Investment income | 970 | $4,924 | 0.2% | $4,924 | 0.2% |
| **Earnings before income taxes** | 36,364 | $174,741 | 8.1% | $80,009 | 3.7% |
| Income tax expense | 11,929 | $60,553 | 2.8% | $28,344 | 1.3% |
| **Net earnings** | 24,435 | $114,188 | 5.3% | $51,665 | 2.4% |

# TAKING THE PLUNGE: COMBINING SERVICE AND ONLINE LEARNING

Catherine Levitt & Cynthia Schreihans
California State University, San Bernardino and Palm Desert Campuses

## Abstract

While there has been a steady interest in material that seeks to acknowledge how service-learning impacts students' along with pedagogical methods that seek to enhance online learning, there remains a shortage of information that examines the outcomes of combining both learning pedagogies into one course. Therefore, this paper examines the value and student outcomes of blending service learning within an online curriculum. Findings for this paper were obtained from a pilot undergraduate online, service-learning administrative communication course (Management 350) offered at California State University, San Bernardino and Palm Desert campuses during the spring term of 2009. From this study, themes have emerged that indicate each student enrolled in the course experienced an enhanced commitment to their education and community service, while at the same time were motivated to learn at a higher capacity. In addition, the study also found that service learning adds human interaction to the individual isolation commonly experienced by online students. The study results support that service learning can add value, innovation, and a new pedagogical approach to online instruction.

## Introduction

As an emergence of worthy scholarly practices service learning and online learning have both been deemed "hot-topics" at conferences, in journals, and at universities in general. Both types of learning environments offer the instructor opportunities for innovative pedagogical approaches to course development and overall, seem to be two learning pedagogies that will continue to evolve into the future. Therefore, it just makes good sense, that thinking "outside the box" and uniting both learning environments (service and online) would bring about an innovative approach to instruction. In doing so, students would be provided the opportunity to learn civic and social responsibility while at the same time, receive all the well-known benefits associated with online education.

Similar to other universities across the nation, in recent years the prevalence of service learning has grown at California State University San Bernardino and its satellite Palm Desert Campus along with the prevalence of online learning. Nonetheless, to date, on these campuses, no previous instructor has dared to "take the plunge" and offer service learning to students in an online course. For that reason, this paper is of value. Its content can assist educational professionals inside and outside of the California State University San Bernardino systems that instruct either or both, service learning and online courses. There may be other educators who need a motivational groundwork to think "out of the box" and "take the plunge" adding a new pedagogy (service-learning) to their online courses.

The outcomes and processes mentioned in this paper root in management education and are obtained from a pilot run of a course that did indeed include the symbiotic combination of service learning within an online curriculum. The course mentioned for this study is an upper-division management concentration course, Administrative Communication (Management 350) that was taught during the spring term of 2009 at California State University, San Bernardino and its satellite Palm Desert Campus. The primary data obtained for this paper analyzes a post-course student survey that addresses student learning outcomes and their course comments, community/nonprofit remuneration, and university perks.

Research that supports service learning in higher education is a foundation to practice improvements. Too little is currently known about which practices work best for a classroom design and what implementations achieve optimum student learning outcomes (Eyler & Giles, 1999). Guidance about how instructors should put a particular practice of service learning into an online environment is well, an extremely underdeveloped researched topic. Before readers explore these elements it is best to overview the basic concepts associated with service-learning while reviewing a little about the roots of online instruction.

Service learning is a form of experiential education. Traditionally experiential education in universities offers endeavors that include: internships, field studies, volunteerism, and community service (Furco, 2204). Service-learning differentiates itself from traditional forms of experiential education and many times definitions for service learning can vary from institution to institution. For example, Timothy Stanton at Stanford University poised the question, "What is service-learning anyway?. . .do we distinguish service-learning. . . from other forms of experiential education?" (Stanton, 1987). Focused on various types of experiential education programs, The National Society for Experiential Education defines service learning as "any carefully monitored service experience in which a student has intentional learning goals and reflects actively on what he or she is learning throughout the experience." (1994).

The term "Service-learning" was coined in 1967 to define an internship program at the Southern Regional Education Board. This internship program enabled students to gain academic credit or federally funded compensation for work on community-based projects (Sigmon,1979). The pedagogical practice of SL in higher education was at that time limited to a small number of participants. By early 1990's SL was gaining in popularity and became its own entity, separate from other forms of experiential learning, and distinguishable by, its focus of academic study intertwined with community involvement (Hollander, Saltmarsh, Zlotowski, 2001). A common perception of service-learning includes methods under which a student learns and develops through active participation in an organized experience that helps meet actual community needs. Today, service-learning transcends all disciplines on multiple university campuses across the nation and most notably at CSUSB-PDC.

For the CSU system as a whole, service learning originated under California Governor Gray Davis's leadership, a resolution (AS 2471-99), set Service-learning in motion. The CSU was to make a voluntary commitment to provide its student body and faculty members with various incentives for community-based forms of experiential learning. "Be, it RESOLVED that CSUSB make a commitment to providing students and faculty various OPPORTUBITIES and INCENTIVES to participate in meaningful service learning experiences." "Be it RESOLVED that these opportunities be voluntary rather than compulsory." (CSUSB Faculty Senate, 2008).

According to Thomas Ehrlick, a senior CSU scholar:

> *Service leaning connects thought and feeling in a deliberate way, creating a context in which students can explore how they feel about what they are thinking and what they think about how they feel; through guided reflection, it offer students opportunities to explore the relationship between their academic learning and their civic values and commitments* (2000*).*

Service learning started in 1999 at CSUSB. The program was extended to its satellite campus in Palm Desert during the fall of 2002 (Podolske, 2008). According to State guidelines, when a faculty member develops his or her course curriculum to accommodate students' participation in an organized activity that meets community-identified needs, completes the required fellowship application, and has the application approved by the designated Service Learning Cabinet (members of the campus and community), obtains a consenting signature from his or her department chair, the course structure is officially deemed Service Learning and is advertised in the campus class schedule as such (CSUSB, 2008). Each instructor planning on creating a service-learning course must meet with the campus service-learning coordinator to discuss their ideas and complete the mini-grant application and its requirements (B).

Similar to previous common service-learning descriptions, at California State University, San Bernardino and Palm Desert Campuses, and for the purposes of this paper, service learning is defined as, "a credit-bearing educational experience in which students participate in an organized service. However, for California State University (CSU), San Bernardino-Palm Desert Campus (CSUSB-PDC), community involvement takes on a heightened perspective, because this university campus is the ONLY CSU campus that was built solely on private and community donations.

The campus' existence would never have materialized if strong community university partnerships were not developed. In accordance, it's pretty obvious that civic engagement and working to meet community identified needs is of special importance to area residents. Campus instructors that are able to indentify community needs and work with students to help fulfill these needs foresees service-learning as providing one outlet for the campus to "pay-forward" into the community for the generous support it received in making this campus a reality. At CSUSB-PDC a service learning course is credit-bearing and typically requires a minimum number of service hours with the selected community partner(s). The University states:

> *Faculty who teach service learning courses have found that extending the boundaries of the classroom into the community benefits their students' learning in many ways. Students understand and synthesize the subject matter through a broader range of experience and associations; gain an understanding and appreciation if the community and the diversity of its people; explore an area of study or a career option; critically reflect on personal values and responsibilities as citizens; and gain a belief they can make a difference through their actions. Many students decide to continue their involvement after completing the class* (CSUSB, 2008).

At California State University, San Bernardino-Palm Desert Campus, Service-learning is overseen by Community University Partnerships (CUP). Leveraging university resources to advance the quality of life for California's San Bernardino and Riverside Counties is CUP's mission. "CUP addresses the third goal of the CSUSB Strategic Plan, which focuses on adopting a long-term strategy for university engagement in community partnerships. CUP supports the formation of new community-university partnerships." (CSUSB-CUP, 2008). CUP is the all-encompassing link to faculty who wish to put service-learning into action.

CUP, serving the San Bernardino and Palm Desert Campuses provides many resources to assist faculty members who are interested in working to develop their curriculum to meet the service learning standards: program coordinators, library resources, and curriculum development fellowships. The guidelines that designate service learning at CSUSB-PDC require students in the class to provide a service that addresses community identified needs while at the same time the service experience must elucidate the relevancy of course content, informing the experience with discipline specific knowledge. In the process the opportunity naturally furthers students' civic education while providing "real-world" skill development (CSUSB, 2008).

Generally instructional methods are creatively diverse and discipline specific for service-learning projects. Recommended student participation is a minimum of 15 hours during the quarter and is preferred that the service be provided throughout the term rather than as a one-time experience. Credit for the student is obtained not solely for completing the service assignment(s), but for also producing reflective assignment(s) (CSUSB, 2008). Through community-based work students involved in service-learing are required to meet four learning outcomes; (1) Understand and apply knowledge related to the course, (2) Explore social location and clarify own values, (3) Develop community awareness and practice social engagement and, (4) Demonstrate a commitment to lifelong learning and action.

Today service learning at CSUSB-PDC has grown to be a fascinating, proven successful, form of instruction which encompasses a 360 degree circumference of "win-win" learning objectives across disciplines. The Palm Desert Campus funds approximating 5-6 State service-learning instructional grants per academic year while the San Bernardino Campus funds approximately 12 grants per year (Podolske, 2008). These numbers represents a strong campus commitment to service-learning, student, community, and instructional interest.

Online instruction in the United States began as an advantageous use of the "Information Highway" back in the 19th Century with the creation of the first correspondence course (a partnership between Pennsylvania, Chicago, and Wisconsin State Universities). Expanding on the correspondence course foundation throughout the 20th Century, and adding to enrich the delivery of educational content, multitudes of media were recognized as resources for educational purposes: radio, television, film, audiotapes, and videocassettes. Moving forward in time the 1980's saw educational videoconferencing and the 1990's saw the use of the Internet as an educational medium (Miller, 2007). Since then . . . The use of the Internet and World Wide Web is a common place medium for the delivery of information in an academic environment.

Anyone who works within university walls knows online instruction, courses, and educational programs are growing in number and popularity. Considerable interest exists about educating in

a virtual medium particularly as it relates to improvement. Originally online learning reflected students who were enrolled in course(s) from outside the geographical location of the university (distance learning) (Allen & Seaman, 2003). Online learning isn't distant anymore and this educational medium foresees many campus-based and geographically local students also enrolling in online classes.

As with the definitions of service learning there are many different descriptions used to reference online learning. A review of some of these definitions also demonstrates the progress of online learning from a "distant" perspective to common place in today's educational practices. For example, Khan (1997) believes online learning is an educational delivery approach that targets learners in distance, remote areas by utilizing the World Wide Web as an instructional medium. Carliner (1999) defines online learning as educational material that is presented on a computer. Ally (2004a) describes online learning as the learner's use of the Internet to access materials and interact with the content, instructor, and other learners; and to obtain support in the learning process in utmost knowledge and personal growth.

Just like many universities, California State University, San Bernardino and Palm Desert Campuses offers an expanding inventory of online courses, certificates, and degree programs, which are designed with student accommodation in mind. These courses are resources that help accommodate student schedules, commutes, and disabilities. Worth notable mention, today almost all courses on campus, when not entirely offered in a electronic format, use online materials and platforms to complement and/or create hybrid formats (blended online and traditional learning) (ODL, 2008).

At CSUSB and CSUSB-PDC, instructors who wish to develop online courses and implement technology resources into their classrooms are overseen, assisted, and trained, by the Office of Distributed Learning (ODL) staff. As stated on the second paragraph of ODL's campus website:

> *ODL is the primary point of contact for development, support, implementation and promotion of high quality, accessible academic courses and programs which students complete fully or partially online, through video conferencing, or at off campus centers. Key functions of the ODL include strategic planning, faculty development and support, course design and development, evaluation, copyright clearance, reporting, quality assurance, oversight and accreditation* (CSUSB-ODL, 2009).

Thus far brief overviews of the founding components related to this paper have been presented and specific course study information is ready to be explored.

Administrative Communication (Management 350) is an upper-division management concentration course that must be taken by all business management majors to obtain their undergraduate degree in business administration with a management concentration. The course provides an introduction to communication theory, concepts, analysis, and methods of improvement for interpersonal, organizational, and external environments. It is a course where students begin to focus on the importance of communication as a skill needed in the tools repertoire of a manager.

Since organizations and communication provide the central course theme, the instructor has chosen a managerial communication series as the assigned textbooks for the course. Course texts were chosen because of their all-encompassing integration of communication skills into administration. This series of texts includes seven modules that thoroughly examine important topics within the field of study. To organize course material, specific topics were divided into each weekly lesson topic and presented to students with associated themes.

It must be noted that not all chapters of every module were explored during the course; however, unexplored chapters and the text series as a whole, provide students with a valuable, thorough administrative communication reference library. Without doubt, for students that chose to retain these textbooks, they will provide their home libraries with exclusive references to administrative communication well beyond their college years.

Aligned with the format of most online courses, the Internet was also used as a significant source of reading materials and "real-world" administrative communication examples. Blackboard served as the instructional portal for this course and held many instructional resources: lecture materials, PowerPoint presentations, videos, exams, and simulation exercises. Course lessons and discussion forums were built around exercises that included communication and collaboration with peers and the instructor, with evaluation and analysis for real audiences.

On or offline, instructional practices for teaching a communication course must require that the students indeed—communicate! Atypical, students were routinely expected to review and evaluate their work and the work of other students in synchronous and asynchronous forums attached to each weekly learning module.

Past conversations with professors and students always reveal, by nature, online courses can lack in delivery as basic "black on white" is cold and impersonal and student isolation can occur along with digital information overloaded and lack of "hands-on" applications (outside of a keyboard). In accordance, the outstanding and innovative part of this course was adding a human element of interpersonal communication and live organizations to help diffuse previously stated adversities.

As required by the university, this course was advertised as an online service course. For many students, service-learning is a vague concept, as few of required courses are offered in this format. On the first logon to the course platform (April 6, 2009), students discovered service would be integrated as a key component of the required coursework undertaken. With interest and wonder, they continued to read that they would participate in service-learning group assignments developed to enhance their administrative communication skills. To do so, 1 out of 3 provided nonprofit organization's causes would become part of their personal causes. Espoused course objectives clearly conveyed that meeting these assignment objectives was not an option (if they were to planning on passing this course).

The syllabus stated that 15 hours of their time would be needed to complete the actual service project, some travel would be required, and that groups would be required to meet in a face-to-face medium, whether utilizing online resources such as SKYPE or "brick and mortar" institutions such as Starbucks'. Which group communication mediums were channeled was at their discretion.

All and all, service assignments (preparation and final) would enhance class readings, discussions, lessons, and written assignments. Students' first exposure to service-learning concepts, not alone, service-learning in an online course concluded. The central goal of the course was to develop students' administrative skills in a "real-world" practical "hands-on" approach as educated practitioners instead of students working with textbook vignettes and conceptual models. The first five weeks of the course focused on learning basics administrative communication principles and students did not "dig-in" to their service projects until after midterm exams.

To briefly define course expectations, the instructor felt it was important to prelude information about the course's structure and final project in introductory materials as exemplified below.

One of the objectives of community service learning is to allow students to give back to the society through work with local organizations. Service-learning projects are varied and usually include such endeavors as hands-on, helping projects, internship placements, and volunteer activities, etc. This course's assignment will initially take a step back from this level and first focus on a type of pre-service learning that educates business students about developing persuasive business documents geared for online fundraising (current trend in administrative processes). Afterwards, assignments and the final project will move forward allowing students the opportunity to actually contribute to the needs of a "real-world" organization by orchestrating an online fundraising campaign and interactive associated donation website. Students will choose between three participating nonprofit organization to utilize their efforts. Donations act as accolades to the efforts spent in creating a "winning" effective, online fundraising campaign.

Fundraising is this course will be competitive in nature between assigned class groups. Competition winners will earn the support and donations from all other students in class. On top of providing a solid learning environment that teaches multiple forms of administrative communication, program development, and fundraising strategies, students will completely learn about their chosen organization's history, structure, mission, vision, and purpose. It's anticipated that students will derive intrinsic rewards from helping an organization fulfill the needs of others. Ultimately, it is predicted that students will have fun while competing with one another.

The beauty of this assignment is the benefits will be three-fold. Positive outcomes and a "win-win" situation for all stakeholders are foreseen: (1) community partnerships, (2) students and, (3) the university.

> Community Partnerships: This project generates donations in the form of in-kind gifts that support in-need local nonprofit clients. Participating organizations are provided exposure to student populations whilst improving community awareness about their organization's mission, vision, and purpose. New networks will be housed and new professional contacts made. Invested groups of students now share in the visualization of helping achieve organizational objectives. Human investments create human capital. Many students will continue to support future organizational endeavors and causes; possibly pursuing careers within their nonprofit organization.

Students: A better understanding of administrative communication and its "real-world" practices is demonstrated. This project teaches students the "ins-and-outs" of developing a fundraising campaign, associated legal policies, document creation, planning strategies, marketing concepts, and website design. A human interaction component is fashioned into, what would otherwise be an isolated online environment, thus improving students' interpersonal communication and group skills. Additionally perks would include acquiring professional skills that will in-turn increase overall professional development and shining resume entries.

University: The university gains from this project by expanding its community contacts and by uniting nonprofit organizations with the campus. The campus is enhanced by the addition of "real-world" curriculum components and community recognition. Students can now bring obtained project knowledge into classroom lectures enhancing shared-knowledge for all.

From this section's information, service-learning philosophical principles are aligned with course content and intertwine many forms of documented outcomes such as Giles and Eyler (in Cooper & Julier, 1995) description of four service-learning principles:

> *(1) Students learn best when they are actually involved in their own learning; (2) students learn best when the learning project is seen to have intrinsic interest and not merely as an exercise; (3) writers develop language and discourse skills best by writing for a variety of audiences, not only for the teacher as examiner or evaluator; and (4) experience is education only if it is structured by the teacher through "the process of problematic and inquiry, and the phases of reflective thought* (pg.79).

The most critical skills a business communicator can acquire are the abilities to impart information factually but persuasively to various stakeholders delivering information in a manner that is easily understood. Motivating people, selling a idea, planning an event, prepping materials, gaining support, and defending a cause, define many of the specifics associated with administrative communication (Collins, 2009) (precisely, the specifics of this assignment).

Participation is very important in this class and for the final project as students can expect many interactions between organizational participants and their assigned group members. Class meets in a virtual format, but there will be work done outside of class. A small amount of travel is required. Outside work will total 15 hours of service time per student over a 5 week period and consist of: interviewing organizational representatives; client assessments; and donation planning; donation purchases and collections; and in-kind gift delivery.

In groups, students will experience working in an administrative communication capacity for a not-for-profit organization. All class members will read, research, write persuasively with reflection, and present a Web-based organization (fundraising site). Finished assignment requirements will be worth 150 points with an opportunity to earn 10 extra credit points. In addition, weekly course modules will require each group of students to learn about and complete: a case statement; a persuasive briefing memo; a marketing plan; and associated advertising materials; a gift plan; web-based graphics; visual aids; "catchy" fundraising slogan; and solicitation strategies.

Emphasis on this project must be placed on matching fundraising techniques to donors' interests, capability, and inclination to give. In the course literature, students will be exposed to many administrative concepts including regulatory issues and guidelines, and pertinent IRS requirements. Students must assign a team leader to each group and by consensus, must select 1 of 3 participating organizations to work with/for throughout this term. Students will research assigned organizations and meet face-to-face with associated administrators.

Reflection activities surround much of what has been written on effective pedagogy for service-learning. In this course, reflection assignments will include both, written and verbal activities. Thesse processes have been documented to commit greater volunteerisms and stronger beliefs about improving social structures which enhance pro-social reasoning and cognitive development (Bathcelder & Root, 1994: Cone & Harris, 1996; Giles & Eyler, 1994).

The process of reflection is a core component of course learning and consequently, will be a core component of this class project. In-class and out, reflection is necessitated in the proceeding four forms; (1) evaluation of document (articles, websites, brochures, and flyers), (2) guided group critical thinking discussions, (3) weekly journal activities and, (4) exit surveys.

At term's end "winners take all" as students will review the projects completed by their peers and cast a vote for the fundraising project they feel is best developed. Votes will include comments of "why" they feel this campaign and website is most effective. Winners receive 10 extra credit points for their work. Winners collect and submit aligned in-kind gifts. Further assignment guidelines are provided in the course content.

Data from this study came from a post course survey administered to all students that successfully completed the class. All of these students participated in the survey as doing so was worth points toward their final grade. Survey data was collected during the 11$^{th}$ week of the term (final's week). It should be noted that 33 students originally enrolled in the course but 3 of the 33 dropped the course within the first 3 weeks of the term. It is not known whether those students that dropped the course did so due to the service requirement or for other reasons. The survey was administered in an electronic format "hot-linked" into the course's Blackboard platform.

Study participants included 30 (13 males and 17 females) (Survey, Question 1) undergraduate Administrative Communication (Management 350) online students at the San Bernardino and Palm Desert Campuses during the spring of 2009. Demographics of the study participants were consistent with those for the campus as a whole. Student ages ranged from 21-45 with 70 percent being between the ages of 25-35. It is unknown whether the students selected themselves into the course because of service-learning, the online format, both, or just because the course was a requirement for degree obtainment? Self-selection is not too important to this study as its goal is to look at the outcomes of combining two learning pedagogies (online and service) into one course. This study specifically focuses on ways blending pedagogies improve online learning and "how" these outcomes are perceived by the students in regards to quality learning.

The required completion of course assignments and the final project is the independent study variable. The dependent variables are in the form of survey questions that examine the students' civic and social attitudes towards service-learning and educational value associated with online instruction. Survey items were coded to reflect positive, neutral, and negative responses. Such as, items on the survey (Questions 2-16) offer responses on a 5 point Likert Scale: "Strongly Agree" (1), "Agree" (2), "Neither Agree nor Disagree" (3), "Disagree" (4), "Strongly Disagree (5). Ethnicity of students is not reviewed on this survey; however, gender is because according to past research, volunteerism is more likely to be administered by females (Sax & Astin, 1997).

Three nominal questions were included in the survey (Questions 1, 17, and 18). Question 1 addresses gender, Questions 17 queries if this was the student's first online class, and Question 18 asks if this was the student's first service-learning course. Responses for these questions were coded 1 for Male, 2 for Female, 1 for Yes, and 2 for No, respectively.

As results of the following table shows, the enjoyment and value gained out of the course was outstanding. It is rare that these types of scores are obtained on surveys. The following represents the mean scores of the post course survey (Questions 2-16):

Table 1: Management 350 Post Course Survey Results

| Question Number | Survey Question | Mean Score |
|---|---|---|
| 2. | The service project for this course enhanced my education. | 1.71 |
| 3. | The service aspect of this course helped me to see how my formal education can be used in everyday life. | 1.80 |
| 4. | The service aspect of this course helped me to see how my education can be used in professional environments. | 1.80 |
| 5. | I will continue to support the service organization after this course ends. | 2.07 |
| 6. | As a result of this service learning course, I have improved my administrative communication skills. | 1.80 |
| 7. | As a result of my service learning experience, I have improved my critical thinking skills. | 1.97 |
| 8. | As a result of my service-learning experience, I am more award of community needs. | 1.83 |
| 9. | As a result of my service-learning experience, I have learned more in this class than I would had if I did not participate in a service-learning experience. | 1.80 |
| 10. | I would take another service-learning course again. | 1.90 |
| 11. | Service-learning made the online learning environment more interesting. | 1.63 |
| 12. | As a result of service-learning in this online class, I was able to build relationships with fellow classmates. | 1.43 |
| 13. | As a result of service-learning in this online class, I was not isolated in my learning environment. | 1.47 |
| 14. | I think more instructors should take the initiative to implement service-learning into their courses. | 1.77 |
| 15. | The service aspect of this course made the online environment interactive. | 1.60 |
| 16. | I would recommend a service-learning course to other students. | 1.63 |

Noted is that for survey question 17 (not include in the above table) statistical frequencies convey that for 76.7 percent of these students, Administrative Communication (Management 350) was not their first online course. Survey question 18 (also not included in the above table) and its data consolidation reports that for 87.9 percent of the class this was their first service-learning course.

Seeking correlations between variables for gender (Question 1) and survey attitudes about he students' online service-learning course, a Pearson Moment Correlation was calculated. This correlation query consisted of 14 variables: Questions 2-16. No correlations were established. Contrary to Sax & Austin's research on gender and volunteerism, gender played no role in volunteer endeavors for this course; however, the difference in research findings is explainable as the volunteerism in this course was mandatory and not optional as reviewed by Sax & Austin (1997).

There were significant correlations between students who reported Administrative Communication was their first service-learning course and how their education can be used in everyday life and professional environments. The findings for this correlation were determined by using a Pearson Moment Correlation between Questions 18 and survey questions: Q2, Q3, and Q4. The correlations were significant at level .05 (2-tailed) for Questions 3 and 4 both equaling .429. For Question 2, the correlation was significant at .01 with a positive correlation of .581 (2-tailed).

Running another Pearson Moment Correlation using Question 16 (recommend service-learning courses to other students) and survey questions 2-16 revealed many positive outcomes and all but Question 5 in the string were established to hold significance at the .01 level (2-tailed) with results at or between .456 t0.887. These correlations reinforce those students who took this class benefited greatly and would highly recommend the online service-learning class to to other students because they found the project and process to:

- enhance their education;
- help them see how formal education can be used in everyday life;
- help them see how education can be used in professional environments;
- improve administrative communication skills;
- improve their critical thinking skills and problem-solving skills;
- make them more aware of community needs;
- learn more than in a non-service-learning course;
- seek taking another service-learning course;
- made the online learning more interesting;
- built relationships with other students;
- decreased isolations in the online classroom;
- wish more instructors would develop service-learning courses;
- and, made the online environment more interactive.

Examined above are numerous outstanding findings that support the use of service-learning in an online administrative communication course. Multiple significant correlations were found in regards to student outcomes and satisfaction with this course.

As demonstrated by the above primary research and student comments, learning satisfaction was achieved at a high-level during this course. Learners in this course had many weeks of pragmatic opportunities to test and apply their communication skills not only in an online setting but with "real-world" reviewers and peers. Successfully moving from writing private documents viewed only by only their instructor to successfully writing public documents viewed by an inventory of audiences prompted students to give 100 percent of their effort toward finished products.

Due to this study, the instructor is convinced that the course has provided an outlet for students to not look upon online courses as "independent study" but as classes that can be developed to successfully include active human participation joining people together to support human related causes. Components associated with the concepts of service, eliminate online study isolations and bring those traditionally boring "black on white" Blackboard platforms and formats, etc., to life.

More importantly students moved from studying textbook examples and venues to studying practical applications. Clearly, they have been shown "how" their education can indeed benefit the lives of others and how their academic skills apply to business and society. The analysis of this course truly demonstrates adding service-learning to an online course instills an increased sense of social responsibility, activism, and learning that leaves an open invitation for students to use their education to help others.

Now, students are familiar with a few different non-profit organizations. Students have been given a chance to "make a difference" within an organization whose goals are close to their own hearts by building philanthropic accomplishments. While some of these students may have studied concepts intertwined with administrative commutation in the past, they have never previously been provided the experience to put their skills to work for the betterment of society.

Past researchers have verified (Astin, Sax & Avalos, 1999) that 60 percent of college students were not involved in community service and few volunteered their time to assist others. Astin found a direct correlation to volunteer participation during college and volunteer participation nine years after college. Those who were introduced to community service and volunteerism in college were twice as likely to provide community service and volunteerism after graduation. Therefore, not surprisingly, this course laid the foundation for students to continue to support philanthropy, volunteerism, and community service past their graduation dates. Documented results of this class's project saw student groups raised better than $500.00 worth of donations and in-kind gifts to support the winning class organization. The participating organization in-turn received interest, recognition, awareness, free advertising, new marketing ideas and concepts. Plus, a solid relationship was established between the organization, campus, and its students.

Non-profits many times depend on community volunteers to complete tasks, these volunteers usually do not have the education or expertise that college educated students possess. Investing in student resources does pay off for community organizations, today and tomorrow. Because these students produced compelling information for specific fundraising campaigns, it assisted in building a long-term strategy of community support. Media campaigns and administrative documents, not to mention website development are services that expend a great deal of cash

outlay for organizations to develop. The students saved these community organizations a vast amount of monetary outlay that can now be allocated be better uses such as, fulfillment of client needs. In closing, this project provided the community participants with a more distinguishable face. Contribution sources and participation may lead other organizations to seek out campus students as new sources for philanthropic endeavors. Unanticipated, this project provided community participants with many new resource originations and benefits.

Opinions rest in online instruction and service-learning as being the "wave of the future" but in spite of this; few thoughts come into play about mixing both learning pedagogies into one when instructors first think about new course development. Why? The concept is still unique, or possibly, it is because there are still perceived weaknesses to online learning? Examples of online weaknesses would include: lack of opportunity to practice knowledge and demonstrate skill obtainment, isolation of students, limited access to feedback and evaluation, and deficient human interaction (Bennett & Green, 2001). Additional thoughts may be that some instructors have not been exposed to the benefits of service-learning.

The irony here is that adding a service-learning component to an online course does indeed, exponentially strengthen the perceived weaknesses of online learning by providing students the opportunity to practice knowledge, demonstrate skill obtainment, and prevent isolation, while adding feedback and evaluation— all in a "real-world" applicable approach At this point, it's a good idea to spread the word about blending both instructional formats into one.

Impressions and information contained in this study are based on the creation of one online service-learning course focusing on administrative communication. The content and in no way attempts to answer or offer advice on all the outstanding questions that may arise when implementing service-leaning into an online course, within other business courses, interdisciplinary courses, and/or on other university campuses. Little research is available to assist instructors on symphonically blending both learning pedagogies (service and online) into one course. Administrative Communication (Management 350) required multiple forms of communication in an online environment including working in a group environment to create an online fundraising campaign for a local non-profit organization and service-learning reflection activities. It is not known if other types of service and reflective assignments would create the same results?

The small number of student participants further placed limitations on this study. To thoroughly examine the outcomes of this course, students must be repeatedly surveyed during future terms to increase the amount of data available and its interpretation. Additionally, further relations to service-learning and online instruction could improve the body of knowledge generated from this study such as, diversity, ethnicity, participant-researcher relationship, and community relationships with students. The statistically significant interpretations, frequencies and correlations for this data were very high. It may be possible that the professor's review of the student surveys could have slanted the results and made participants reluctant to respond honestly. However, the reverse may also hold true with all of the above.

A future direction for research on service-learning and online courses may be to administer studies of comparison between university campuses. Study validity could only increase with larger research populations. Future research also needs to focus on what types of online service assignments have a heightened impact (e.g., hands-on versus textbook and independent study) in an online course. Future semesters may manipulate and adjust the original service-learning projects students complete in administrative communication because they will be working with other community-based organizations.

Future research will need to examine factors that have an impact on five variables; (1) type of service activity, (2) amount of service activity implemented into the course, (3) the nature of the service-learning experience, (4) the amount and type of reflection activities used and (5) entrance survey versus exit survey, (6) the amount of training provided to the student prior to engagement in the online service environment. That said, in general, not all forms of administrative communication techniques have been evaluated for service learning/non-service learning differences.

Instructors need to recognize that combining service learning and online instructions can enhance the educational learning experience for students. Student's want and need more educational options. The symbiotic blend (course structure) appeals to students while teaching them civic responsibility and eliminating online isolation. Students are eager for service-learning and online courses to help them prepare for their professional futures. Combined, these concepts extend basic pedagogy for both teaching platforms.

This study's service experience clearly added a most popular aspect of the course as seen by the survey results and student reflective comments—they shout enthusiasm! What has been recognized from this study is a clear picture that service learning can enhance an online class. Adding information about online service-learning does not provide a prescription for how service-learning "should" be implemented into an online class, but rather than it can be effectively implemented. Validated online service-learning can enhance scholarship and eliminate many adversities traditionally associated with online learning. It is unrealistic to think that this study will ever lead to a precise picture of service-learning in an online classroom; therefore, let's call this study a beginning.

As always, it is up to the individual instructor to decide for him or herself what is important to facilitate within a given course. The data in this study suggests that combining service-learning into an online course promotes positive changes in student learning and perceptions about their learning. The instructor believes that these blended pedagogies is worthy of consideration with any online course development in any discipline. Finally future research should systematically assess all aspects of the online service-learning experience. As many professors have experienced, students gravitate to courses where learning is innovative, interactive, valuable, online, and includes a service component. "Taking the plunge" is a probability as doing so, has proven to be effective in Administrate Communication (Management 350) at CSUSB-PDC during the spring of 2009.

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# DOES SIZE MATTER? ETHICS APPLIED TO SMALL BUSINESSES COMPARED TO LARGE BUSINESSES

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## Abstract

Considering the normative statement that both large and small businesses should follow the same ethical and moral standards, this paper analyzes the perceptions of individuals based on the relative ethical behavior of small business as compared to large business. The study of ethics focuses on the differences between what is right and what is wrong in society which affects both small business and large business due to their obligation to the public and their stakeholders. Both entities are guided by the same standards and both are expected to meet all legal regulations and ethical standards.

The analysis employs surveys to gauge the public's perceptions of the ethical decision making by management in both small business and large business. The survey also analyzes the role of those ethical decisions within scenarios and their impact on the individuals' patron behavior in small business as compared to large business. Statistical analysis has been utilized to test the authors' overall hypothesis that the public is generally less concerned about ethical decision making of small business relative to large business. The implications of these findings for both large and small businesses are provided with the analysis and suggestions to correct the disparity between both entities.

## Introduction

During the past decades it has been evident that ethics has become the hot topic in business. However, much of the talk is not comprised of all types of business it involves primarily the large corporations. Large corporations such as Enron have caused much grief to those around them and everyone that they employed. Due to this reason regulations such as the Sarbanes-Oxley Act have been enforced to hold large businesses accountable. While these regulations have focused solely on large corporations, efforts to regulate small businesses have been small. It is estimated that small businesses make up over 80% of all business in the United States of America. That is a huge sector which is unregulated due to its size. While the adverse actions of each entity do not do great harm to the economy; the cumulative damage of all components of the group could have devastating impacts on the general economy.

## Literature Review

Businesses today are completely different than the businesses of years past. Today, business ethics has become an area of great concern in both corporate culture and academia. Companies such as WorldCom and Enron have caused people to reevaluate philosophy and business. Ethics can be defined by the morals that people and companies hold. Although internal and external forces influence businesses, there are three issues that affect issues in business. These three issues are systematic, corporate, and individual.

To truly understand each factor one has to understand how each of these issues differs and how they influence the business itself. Systematic issues analyze ethical values in economic, political, legal, and other social systems in which the business operates (Velasquez, 2006). An example of this would be a question of morality about the current laws pertaining to accounting systems. Laws influence the actions of people because they stem through consequences with the local or federal government. People tend to be scared of a higher authority more than self punishment.

The second factor is corporate issues which are issues of morality of internal activities such as policies, practices, and organizational structure (Velasquez, 2006). Corporate issues are based on corporate cultures. If a company treasures capital gains more than human capital the company would then lay off employees to save money. On the other hand, a company that treasures its employees is more likely to take a cut and keep their employees. To say that one company is more ethical because of their decision lays in a company's moral standards.

The idea of moral standards stems from the third type of issue which is the individual issues. Individual issues are issues that are based on individuals within a company along with their behaviors and decisions (Velasquez, 2006). This includes the moral standards of individuals. Moral standards are standards that are set by the individuals themselves and by no other governing body. Hence, each individual has a right to stand for what they believe in.

It may be simple to take these three factors and state that this is common sense information; however, it is just as complicated to say that there can be one rule that can apply to every situation that is similar. In cases where individual morals differ from those of corporate or systematic, it is easy to assume that one would no longer pay attention to their place of business or the entity that is different. However, humans are prone to being victims of society and need to supply for their family. Knowing that something unethical is occurring at a place of business does not mean that the person will just walk away whether they have worked in small or large firms.

Decisions of a business affect all tiers of the organizational structure which in turn affect the lives of all stakeholders of the company. Therefore, ethical standards have risen due to the current corruption in many large businesses. News reports of Nike and Merck have grabbed the attention for case studies and have become the top selling stories. The news ran the stories that exposed the fragile nature of the corporate worked to their affect on the country's economy.

Due to the global impact of large corporations the public's eye is primarily on large businesses; however, ethical issues arise in small businesses as well. Lisa Miller states that small businesses "were overlooked when Wall Street's mega-scams and scandal came to light (Miller, 2003). For people that analyze and teach ethics "business ethics have almost invariably concerned the doing, indeed generally the misdoings, of large companies (Quinn, 1997)." Quinn noted that in the late 20th century there has been an increase in the economic activity of small businesses (Quinn, 1997). He states that not only do the managers have to be observed so do the employees. The employees have want approval of their peers which is also accepted by the manager/owner (Quinn, 1997).

In large businesses it seems easier to separate you personal ethics from businesses ethics. In small businesses the relationship with one's coworkers becomes a sub-family relationship making it that much harder to make "ethical" decision. The overall factors that influence business ethics derive from personal ethics and how those ethics affect others. Miller points out that it is an assumption that small businesses do not need a code of ethics however, they have a bigger temptation to b involved in "dubious business practices (Miller, 2003).

In Mark Schwartz essay *A Code of Ethics for Corporate Code of Ethics,* Schwartz finds that over ninety percent of large corporations have a code of ethics (Schwartz, 2002). He concluded that there a six universal moral standards in four different sources. The moral standards that he looked at included trustworthiness, respect, responsibility, fairness, caring, and citizenship (Schwartz, 2002). Due to these criteria Schwartz states that a code of ethics should be constructed on factors that could be audited. His study provides a normative foundation for evaluating a corporation's code of ethics.

In a 1981 an article by Brown and King analyzed the influences and perceptions of small business ethics. In their foundational work Brown and King realized the disparity in public awareness between small business ethics and large business ethics. Brown and King surveyed a small group of individuals consisting of "small business" respondents and "other" respondents who were mostly employed by large corporations. Brown and King's research sought to answer three questions. First, the research asked "How high are the ethics of small business people perceived to be?" Second, "Compared to others, what causes the behavior of people in small business to be more or less ethical?" Finally, "What are the prevailing small business attitudes concerning ethical issues?" (Brown and King, 1981).

Brown and King found that there was a surprisingly small difference in the responses between the two subgroups of respondents. The research conducted by Brown and King examined the perspectives of those in the various sized business. The research left a gap in the general public's perceptions of the ethical actions between large and small business.

The Center for Business Ethics surveyed Fortune 1000 industrial and service companies to see how they have instilled their ethical values to compare their results from the study they performed in the mid 1980s. Their survey showed some progress but, not enough (Center for Business Ethics, 1992). Ethical standards fall in line with legal regulations. Sandra Malach, et al. believe that incorporating legal planning into business planning to avoid legal issues and to protect the businesses most important assets (Malach, Sandra et al, 2006). While legal action is important it is important to focus on consequences in a workplace outside of the any punishments.

To further analyze ethical dilemmas it is important to observe the consequences at a workplace. One consequence that business can apply is a zero tolerance policy in a workplace. This ethical dilemma is especially interesting when applied in a small business setting, and contrasted with techniques applied in large corporations. The ethical compass of the theory for the zero tolerance policy is Kant's Categorical Imperative. Kant's Categorical Imperative is defined by the rule that people should "Act in such a way that you treat humanity, whether in your own person or in the person of any other, always at the same time as an end and never merely as a means to an end (Stanford, n.d.)." Kant's Categorical Imperative is a very restrictive rule to live by and cannot practically be applied to everyday life. However, when discussing ethical dilemmas in the workplace, the Categorical Imperative should not be overlooked.

The *Zero Tolerance Policy* embodies the Categorical Imperative in the sense that everyone must ask himself/herself whether they would be willing to have the same behavior applied to them if the roles were reversed. In the business setting the Categorical Imperative has a special value; it helps mitigate moral hazard.

Moral hazard was once described as "a situation in which a party is insulated from the consequences of its actions…Thus protected, it has no incentive to behave differently (Ahrens,2008)." In the business setting, moral hazard can be devastating to the culture of the company and can eat away at the profit margin.

Consider an employee who is discovered to be "moonlighting" or working an untaxed second job during hours in which the employee should be giving full attention to their actual job. This behavior may seem harmless and may only warrant a verbal warning, but when the other employees discover how easy it is to get by with unethical behavior they are incentivized to act unethically. This slippery slope scenario results only in the necessary termination of the unethical employee. When an employer establishes that unethical behavior will not be tolerated the result is the strengthening of the corporate culture and the avoidance moral hazard. However, this scenario might work differently in a small business.

In a small business the cost of a zero tolerance policy can be devastating. The costs associated with replacing an employee in a large corporation is easily spread across the entire entity as a fixed cost of doing business; this is not the case in the small business. The employer-employee relationship in the small business, by nature, is more flexible and more personal. This flexibility can allow for a more informal agreement, between management and employees, to be made. Finding a "win-win" solution allows for Kant's Categorical Imperative to be upheld and moral hazard can be avoided.

In a large publically traded company this kind of arrangement cannot be made because not all of those who are residual claimants (owners) can be spoken for. In the large publically owned company the zero tolerance policy should be followed, but in a small privately owned company a modified zero tolerance policy can be applied.

Kant's Categorical Imperative can be a useful tool when designing corporate policy in publically traded companies. The zero tolerance policy should be applied in publically traded companies. In addition, Kant's Categorical Imperative should still be applied to design a modified zero tolerance policy in small private companies.

To solve the issue of what the zero tolerance policy entails, the company needs to implement a code of ethics in their organization. Eberhard Schnebel and Margo A. Bienert state that a code of ethics strengthens an organizations success therefore improving the overall value of the company (Schnebel & Bienrt, 2004). The value that is added is the public's perception that the business is there to benefit the community.

L. Spence studied a similar phenomenon as this essay explores. In a 1999 study L. Spence found that there is a lack of information on any correlation between small businesses and their ethical standards. The reason for this is because small firms receive little attention by the media which makes them a quick oversight (Spence, 1999). Four years later L. Spence wrote an editorial with R. Rutherfoord to explore the sociological perspective in the field of ethics (Spence & Rutherfoord, 2003). Due to these two studies we have been motivated to explore the issue further and gain insight on why there is a lack of information on the issue.

## Hypotheses

As discussed earlier, the objective of this pilot study was to examine the differences in respondents' perceptions of ethical dilemmas and ethical standards in small business as compared to large business. In order to facilitate the primary research objective the following working hypotheses were formed:

H1: The size of the business will have no impact on consumers' shopping decisions when ethical dilemmas are present.

H2: The size of the business will have no impact on the actions of employees when ethical dilemmas are present.

H3: The size of the business will have no impact on the respondents' perception of the incentives associated with acting ethically.

H4: In general, respondents believe that small businesses should be held to the same ethical standards as large corporations.

These hypotheses are based on the supposition that individuals will be more lenient or forgiving of the shortcomings of small businesses relative to their large counterparts.

## Methodology

The study was initiated with the creation of a preliminary (alpha) survey. The alpha survey resulted in fourteen respondents and was conducted by means of convenience sampling. The alpha survey was a paper based survey consisting of thirteen questions. The survey included demographic questions as well as analysis questions. There were mixed results on the alpha survey mostly due to the confusing survey design associated with strict time constraints. While the alpha survey did not provide sufficient data, it was useful as a tool in the creation of a secondary (beta) survey.

The beta survey instrument consisted of two separate surveys. One survey was specific to small business while the other was specific to large business. The surveys were created and distributed electronically using Survey Monkey. The goal for the beta survey was a total of 100 respondents for each survey resulting in an overall total of 200 respondents. The small business survey yielded 105 useable returns, a 94.6 percent return rate. The large business survey yielded 107 useable returns, an 84.3 percent return rate. Each survey included five common demographic questions, two common questions pertaining to ethics, and eight questions relating specifically to either small business or large business.

The survey was distributed broadly across various social networking sites and throughout the Christopher Newport University community. Due to time and budgetary constraints the beta survey consisted mostly of opportunity sampling and snowball sampling. The authors recognize the drawback of an opportunity sample; however, the research question in this pilot study can be adequately answered using this technique.

The analysis questions on both the small business and large business surveys consisted entirely of binomial data. The respondents were limited to either "Yes or No" or "I agree or I disagree." For the purpose of testing the hypotheses (H1, H2, and H3) statistical analysis will be used to measure the difference between the proportions of the two samples. For the final hypothesis (H4) the analysis will simply state the overall proportion of respondents in both surveys who answered favorably and interpret the results. Hypotheses H1, H2, and H3 will be tested at $\alpha=.10$, $\alpha=.05$, and $\alpha=.01$ levels of significance.

## Findings

The small and large business beta surveys consisted of 64.0 percent and 44.1 percent female respondents respectively. Both surveys where characterized by a mixture of respondents' self reported race. The racial composition of the small business survey respondents can be seen in Figure 1, while the racial composition of the large business survey respondents can be seen in Figure 2. Variety was also evident in the age of respondents in both surveys. Both surveys returned an age range from "younger than 18" to over sixty. The actual breakdown of respondents'age can be seen in Figure 3 [Appendix D]. The largest group of respondents were in the 21 -23 years old demographic. This is largely due to the sampling method and is representative of the campus.

| Small Business Respondents | |
|---|---|
| **Race/Ethnicity** | **Response Percent** |
| Caucasian | 68.5% |
| African American | 10.8% |
| Hispanic/Latino | 3.6% |
| Asian | 15.3% |
| Other | 1.8% |

**Figure 1**

| Large Business Respondents | |
|---|---|
| **Race/Ethnicity** | **Response Percent** |
| Caucasian | 70.9% |
| African American | 8.7% |
| Hispanic/Latino | 9.4% |
| Asian | 8.7% |
| Other | 2.4% |

**Figure 2**

Education of the respondents in both surveys varied from some high school to graduate school. Both the small business respondents' and the large business respondents' education can be seen in Figure 4 and Figure 5 respectively. Of all respondents, roughly 64 percent identified that they had formally studied ethics while roughly 35 percent identified that they had not formally studied ethics. Roughly 87 percent of the respondents for both surveys had at least some college.

| Small Business Respondents | |
|---|---|
| **Educational Attainment** | **Response Percent** |
| Some High School | 3% |
| High School Grad | 11% |
| Some College | 59% |
| College Graduate | 18% |
| Graduate School | 10% |

**Figure 4**

| Large Business Respondents | |
|---|---|
| **Educational Attainment** | **Response Percent** |
| Some High School | 1% |
| High School Grad | 9% |
| Some College | 65% |
| College Graduate | 20% |
| Graduate School | 5% |

**Figure 5**

After the collection of helpful demo graphic information the survey then began to collect data relevant to the research question. First the survey presented both groups of respondents with three common business scenarios relevant to either a small or large business. First both surveys asked if the respondent would report a coworker for stealing in their respective businesses size. When the scenario took place in a small business 58 percent of respondents reported that they would not report a coworker for stealing. When the scenario took place in a large business only 21 percent of respondents said that they would not report a coworker for stealing.

The scenario then shifted to ask if a respondent would report a supervisor to the authorities for falsifying documents. In the small business 37 percent of respondents would report their boss to the authorities for falsifying documents while an overwhelming 84 percent of respondents would report their boss given the same scenario in a large business. The final scenario asked respondents if they would turn their "friend" in if they saw him stealing. In the small business only 33 percent of respondents would turn their friend in for stealing; conversely 50 percent of respondents would turn their friend in given the same scenario in a large business.

The next series of questions in the survey were designed to evaluate the respondent's shopping decision when presented with ethical dilemmas in both small and large business. Both groups generally favored boycotting business for acting unethically. First both groups were asked whether they would boycott a business for hiring illegal aliens and paying them "under the table". When applying the ethical dilemma to a small business 54 percent of respondents reported that they would boycott the business while a similar 56 percent would boycott a large business for the same action.

The respondents were then asked whether they would boycott a business for polluting the environment. When considering small business patronage 65 percent of respondents would boycott the business while 72 percent would boycott a large business for the same act. Finally the respondents were asked if the ethical behavior of a business influenced their shopping decision. Only 63 percent of respondents said the ethical behavior of small businesses influenced their shopping decision while 81 percent reported that the ethical behavior of large businesses influenced their shopping behavior.

The next question presented to the respondents was the same for both groups. Both groups were asked "Should small businesses be held to the same ethical standards as large corporations?" The responses proportion for both surveys was similar with roughly 76 percent of respondents suggesting that small businesses should be held to the same standards as their large counterparts. Both surveys then made the following statement; "In general, small businesses act more ethically than large corporations." An agreeable response rate of roughly 70 percent implies that majority of respondents identified with this statement.

The survey concluded by soliciting respondents for their opinion on the existence of a "Zero Tolerance Policy" and by asking if their respective business had an "Incentive" to act ethically. Overall, roughly 62 percent of respondents believe that small businesses should implement a zero tolerance policy; conversely, roughly 64 percent of respondents believed that large businesses should incorporate a zero tolerance policy. Finally, 80 percent of respondents believe that small businesses have an incentive to act ethically while only 57 percent of respondents believe that large businesses have an incentive to act ethically.

## Analysis

After collecting and analyzing the survey responses the hypotheses can be tested. In regard to H1, significance was found between the size of a business and the role its ethical decisions played in a consumers shopping decision. The population proportions test showed that the null hypothesis can be rejected at the $\alpha$=.01 with a p-value=.004. In regard to H2, there was statistical significance to reject the null hypothesis that the size of the business will have no impact on the actions of employees when ethical dilemmas are present. The analysis showed that the null hypothesis can be rejected at the $\alpha$=.05 level of significance with a p-value = .0124.

In regard to H3, there was statistical significance to reject the null hypothesis that the size of the business will have no impact on the respondents' perception of the incentives associated with acting ethically. The analysis then showed that the null hypothesis can be rejected at the $\alpha$=.01 level of significance with a p-value = .0048. Finally, when considering the composition of responses on the part of the respondents, an overwhelming 77 percent suggested that small businesses should be held to the same ethical standards as large corporations. Thus, the analysis fails to reject the null hypothesis that in general, respondents believe that small businesses should be held to the same ethical standards as large corporations. Table 1 offers a display of the multiple hypotheses and their statistical levels of significance.

By rejecting three of the hypotheses the analysis is suggesting that there is a skewed perception when criticizing businesses for ethical and unethical actions. According to the analysis people are more likely to base their shopping decision on ethical actions when the store under consideration is a large business. The analysis also implies that individuals are likely to report unethical behavior at a lower rate in small businesses when compared to large businesses. The analysis then suggests that people believe that small businesses have a greater incentive to act ethically. When combining hypotheses H1 and H2 the analysis implies that large businesses, in fact, have more incentive to act ethically. This is in disagreement with respondents perceptions of incentives associated with ethical behavior. Finally, the analysis suggests that individuals believe that small businesses and large businesses should be held to equal standards when considering ethical dilemmas; however, the same respondents favored small businesses in the survey.

Table 1. Statistical Analysis

| Hypothesis | Reject of Fail to Reject | Level of Significance | P-Value |
|---|---|---|---|
| H1: Shopping Decision | Reject | $\alpha$=.01 | .004 |
| H2: Business Scenarios | Reject | $\alpha$=.05 | .0124 |
| H3: Incentives for Ethical Behavior | Reject | $\alpha$=.01 | .0048 |
| H4: Equal Standards | Fail to Reject | N/A | N/A |

## Conclusion

The overall finding of the analysis is that people do generally favor small businesses when ethical situations and dilemmas are present. Tying back to Kant's Categorical Imperative, people should hold both large and small businesses to the same ethical standards. The analysis implies that people understand the normative condition that both large and small businesses should be on equal standing. The analysis also suggests that there may be a dissonance between what people believe and what they practice.

Replication in future research is suggested. This analysis is merely a pilot study due to time and budget constraints. The findings of a more sophisticated analysis would be beneficial to the understanding of the individual's perception of ethical behavior of small business as compared to large business.

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# REDUCING TAX CODE NONCOMPLIANCE: ETHICAL PERCEPTIONS USING THE THEORIES OF REST AND KOHLBERG

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## Abstract

Our study proposes that only after one understands the influences in the decision making process concerning tax evasion participation, namely theories established by Rest (1983) and Kohlberg (1969) will reductions in the occurrence of this unethical practice result. The main research question we pose is: What are the most effective means of reducing tax code noncompliance? Furthermore, we seek to identify the appropriate theories and principles by which taxpayers are to achieve this reduction in unethical behavior. We created and administered a preliminary (alpha) survey to 16 college students concerning the ethical issue of tax code noncompliance. The survey's purpose was to test the hypothesized theory that college students do not understand the topic of tax code noncompliance and the differences between tax evasion and tax avoidance. Upon receipt of results, a follow-up (beta) survey was conducted over the internet. This survey tested the same hypothesized theory as the previous survey, and 100 college students responded. A third (gamma) survey containing the same final questions was conducted online to determine if the results varied when all questions required forced responses. We present our findings and implications of the study in this project.

## Introduction

The long-lived ethical issue of tax noncompliance remains at the forefront of problems society faces today. Arguments which validate tax evasion, as well as those which denounce the act, exist in great numbers. These viewpoints range widely and the sources of justification explaining the occurrence include ethical, philosophical, psychological, and religious theories among many others. This paper does not intend to dispute the fact that the issue of tax code noncompliance is an ethically charged topic, nor that the practice of tax evasion is, by and large, unethical and immoral. Rather, this paper attempts to present a means of preventing tax noncompliance. Further support is provided by a survey conducted to ascertain how business students view the issue of tax code noncompliance and if in fact the college student understands the topic in its entirety. For the purposes of this study, the terms tax code noncompliance and tax evasion are synonymous.

## Literature Review

Background facts and information concerning the topic of tax evasion provide useful insight enabling one to understand the scope of the issue. Andreoni, Erard and Feinstein (1998) reviewed tax evasion in the United States over a thirty year period from 1965 to 1995. In this analysis, Andreoni et al. pointed to four areas of possible interest in the field of tax noncompliance. The study noted that psychological, moral, and social influences may play a major role in the issue of tax evasion. The review envisioned that further research into cross cultural analysis may reveal interesting results in relation to tax evasion.

Multiple studies address the topic of tax evasion and possible viewpoints of the ethical issue. McGee (2006) stated that three distinct outlooks towards the issue developed over hundreds of years: tax evasion is always ethical, tax evasion is sometimes ethical, and tax evasion is never

ethical. Bobek, Roberts, and Sweeny (2007) assert that fluctuations in tax noncompliance occur due to differences in the four social norms: descriptive, injunctive, subjective, and personal. Descriptive norms develop from observations of others to provide guidance on how to act. Injunctive norms arise from one's perception of what should occur by society's standards in a given situation. Norms of the subjective type rely on one's perception of endorsed behaviors by those closest to the person, such as family and friends. Personal norms comprise one's conscience in a sense of standards of acceptable conduct. As the name suggests, they are internal thoughts and feelings regarding behaviors.

The theory of social norms influencing taxpayer behavior is one of the more accepted suggestions proposed to explain the ethical or unethical behavior of taxpayers. For example, Wenzel (2004) conducted a study that supported this "norms theory." The results of this study illustrated the highly-influencing effects of "personal norms" on taxpayer behaviors, as well as explaining the less influential effects of "social norms" (Wenzel, 2004). It is important, however, to recognize the way in which these norms had an effect on taxpayer behaviors. It was found that lenient personal norms lessened the impact of perceived deterrents to tax evasion and, conversely, that only when social norms against tax evasion were strong were taxpayers able to better perceive the consequences of tax evasion and perceive its agents of deterrence (Wenzel, 2004).

Bobek et al. (2007) also deem a person's upbringing as a factor which determines one's social norms, and thus how that person will view tax evasion. Other studies, such as McGee, Ho, and Li (2008) and Cialdini and Trost (1998) provide similar findings. McGee et al. suggests cultural differences allow for a society to hold one of the three stances established earlier by McGee (2006) concerning the issue of tax evasion. Torgler (2004) also found similar results when experimenting with the countries of Costa Rica and Switzerland. The study found differing opinions regarding tax evasion attributable to social norms. Testing found that tax compliance was directly affected by voting on tax enforcement issues. In addition, the study concluded that cultural setting impacted one's ethical decision of tax noncompliance. This is another prominent aspect of the results in the aforementioned Wenzel (2004) study. The findings of his study state that the degree to which people identify themselves with their culture has a significant effect on how influential social norms are on their behaviors (Wenzel, 2004). Therefore, it can be assumed that people of collectivist cultures may have different views and opinions towards tax evasion than would people of more capitalist cultures.

Psychological arguments attempt to explain the phenomenon of tax noncompliance. Yeaton and Stellenwerf (2007) applied the principles of Rest (1983) and Kohlberg (1969) to the issue of tax evasion. Rest believed four stages of moral behavior existed: moral sensitivity, moral judgment, moral motivation, and moral character. According to Yeaton and Stellenwerf, moral judgment, the ability of one to choose the most ethically justified option, is of importance in evaluating the issue of tax evasion.

Kohlberg focused in on moral judgment and established six stages of moral development in order of increasing moral understanding which explained one's level of thought concerning moral dilemmas. The six stages are: punishment avoidance, satisfaction of one's needs, interpersonal conformity, law and order, social contract, and universal ethical principles. Each level describes one's decision making process on ethical issues, which changed over time and with education. These six stages can be split into three levels each containing two stages which broadly describe the stages: pre-conventional, conventional, and post-conventional.

Specifically, Yeaton and Stellenwerf proved Kohlberg's theory in relation to tax noncompliance. The study surveyed 362 students and 89 faculty members of Ramapo College of New Jersey with 18 questions covering the topic of tax evasion. The data revealed that the students and faculty held significantly different views towards tax evasion. This supports Kohlberg's theory of moral judgment in that people's moral judgment adapts over time and with increased education and experience, as the faculty were of older age and higher education.

Along a similar note, Eicher and Stuhldreher (2007) found that attitudes of taxpayers change over time. The study compared two surveys taken in 1999 and one survey conducted in 2005. The 1999 surveys included one conducted by Roper Starch Worldwide, Inc. from a broad population and another survey administered to students of two Pennsylvania Universities (as well as those students' parents). The 2005 survey followed up on the previous survey of the Pennsylvania Universities, but asked only students and the respective parents from one of the Universities. All three surveys contained similar questions in order to maintain the integrity of the study. The findings showed that the passage of time allowed for results to adjust. Although discrepancies existed between the two surveys taken in 1999, the 2005 survey showed significant differences from the two earlier surveys. This study found results similar to Yeaton and Stellenwerf; the results of the parents differed considerably from those of the students.

Another relevant theory discovered in reviewing the literature was that certain "ethical orientations" held by a taxpayer may contain highly predictive qualities for how one will behave when filing taxes, and whether that person will be compliant or not (Henderson & Kaplan, 2005). In this 2005 study, Henderson and Kaplan describe ethical orientations as certain deontological and teleological views towards morals and ethics. However, the study also states that this relationship was only found to exist through mediation from "ethical evaluations," or how a person generally decides to handle problems dealing with ethical issues.

In revisiting Andreoni et al. (1998), one finds that certain occupations may increase the probability for the occurrence of tax evasion. For instance, the amount of taxes understated by the general population averaged $289 in 1988, while the understatements for farmers averaged $1,058 and $827 for sole proprietors. This view is seen in Armstrong and Robison (1998), which studied the issue from an accountant's perspective, providing insight from a career which deals with the issue more frequently. Likewise, married filers and taxpayers younger than 65 years of age produce higher instances of tax evasion. The previous statement lends support to findings of Yeaton and Stellenwerf (2007) in regards to age.

Andreoni et al. lends credence to various other studies as well. For example, trends of the percentage of audits conducted by the IRS each year from 1965 to 1995 decreased, which agrees with principles found by Eicher (2007) concerning the passage of time. Andreoni et al. mentions that 91.7% of all income that should have been reported in 1992 was actually reported and reasons that this large amount can be attributed to either a fear of penalties or social stigma from what others may think if this fact were to be made public. This proposition materializes in the study conducted by Yeaton and Stellenwerf (2007) pertaining to the application of Kohlberg's (1969) six stages of moral development—specifically the first and third stages—and relates to the Bobek et al. (2007) study on the subject of social norms.

Another key factor influencing one's choice to evade taxes taken into consideration is religion. McGee and Cohn (2008) examined results of the Human Beliefs and Values surveys, which asked practitioners of a variety of religions specific questions concerning the ethicality of tax evasion, amongst other things. The data revealed that while tax evasion is seen as an unattractive practice by most religions overall, the opinions of each religion still differ towards the issue of tax noncompliance. The study also produced findings of a survey of Orthodox Jewish undergraduate students from Touro College of New York, who possessed significant education and understanding of the religion. The survey found that under certain circumstances, people viewed tax evasion as an ethical act, but disliked any attempts to justify a practice considered on its face to be unethical. Furthermore, the study found men more accepting of tax evasion as an ethical practice than women.

There are some researchers who assert that limitations intended to reduce unethical taxpaying behaviors should only be outlined by principles within a society's legislation, as opposed to other facets of society that may prevent unethical taxpaying behavior from occurring, such as media pressure or other descriptive norms. In the 2004 British Tax Review, joint editor Judith Freedman proposes that a "general anti-avoidance principle" be enacted into legislation. This would serve as a means of setting law-based "boundaries" to prevent taxpayers and preparers from engaging in unethical tax avoidance schemes. Freedman explains these law-based boundaries by first stating that taxpayer's ethics and morality can, and should, be influenced by the law. A legislative principle such as the one suggested here could accomplish this by providing taxpayers with exact knowledge of how much they must pay their government, along with constructs for filing taxes in a manner that would involve paying the least amount possible, while still following the law (Freedman, 2004). In similar respects, it has been argued, and in many cases proven, that a person's morality cannot sufficiently account for one's fulfillment of the duty to pay taxes and prevent tax code noncompliance (Freedman, 2004). These concepts, for the most part, represent one of many suggestions on how to reduce tax code noncompliance and unethical taxpaying behaviors.

This paper does not intend to dispute the fact that the issue of tax code noncompliance is an ethically charged topic nor that the practice of tax evasion is, by and large, unethical and immoral. Rather, this paper attempts to present a means of preventing tax noncompliance. Of all the possible influences which may affect one's choice to participate in the unethical practice of tax code noncompliance, this paper suggests that the most influential sources are the four social norms and one's moral judgment, as well as one's religion and gender. Other indirect influences towards the topic of tax evasion exist, yet impact one's ethical decision through one of the three aforementioned sources. This article mentions gender and religion only to inform the reader that these factors provide significant influence in the occurrence of tax evasion. Gender and religion will not be discussed within this paper as these factors cannot be easily changed to provide a resulting decrease in tax code noncompliance; doing so would be in-and-of-itself unethical.

## Hypothesis

The main research question that this article is intended to address is: What are the most effective means of reducing tax code noncompliance? Furthermore, this article seeks to identify the appropriate theories and principles by which taxpayers are to achieve this reduction in unethical behavior. In response to this research question, we've developed the following hypothesis: In

order to minimize tax code noncompliance and reduce unethical behavior, taxpayers must fully understand the theories of Rest and Kohlberg. The theory of James Rest referenced in our hypothesis is known as the Four Stages of Moral Behavior. The theory of Lawrence Kohlberg referred to here is known as the Six Stages of Moral Development. This theory can be seen as a derivative of Rest's theory, as Kohlberg used Rest's stage of "moral judgment" to develop his six stages.

## Methodology

Three Surveys were administered in conducting research. The first was the preliminary or alpha, containing 13 test questions and 4 descriptive or demographic questions. This alpha survey was administered to a sample of 16 Christopher Newport University (CNU) of Virginia business students. The survey investigated college student views towards tax code noncompliance and attempted to determine college students' knowledge and understanding of tax evasion and ethical perspectives of the issue. Convenience sampling was used in administering the survey. The respondents were provided no prior information regarding the topic and the questions covered a variety of stances one may identify with concerning tax code noncompliance. Tabulated results discussed in the next section appear in full as well.

After obtaining some insight into college student views of tax evasion, a second survey, known as the beta survey, was created. The contents of the online beta survey included 4 demographic questions and 15 test questions. This survey received 100 respondents which primarily included CNU business students. It attempted to develop findings of the preliminary alpha survey, as well as discover if students understood the differences between tax evasion and tax avoidance. Furthermore, the beta survey set out to determine which of Kohlberg's six stages of moral development each respondent had reached. Again, the results of this survey will also be discussed in the following section.

A third survey was created to determine if answers would change when respondents were forced to select responses to all questions in the survey. This survey, known as the gamma survey, was conducted online containing the same 19 questions as the previous beta survey. This survey, however, received only 7 respondents; thus, the inconclusive results of this survey cannot verify the answers of the beta survey. As the gamma survey's questions are exactly the same as the beta survey's questions, there is no copy of the gamma survey provided. There are, however, the results of the gamma survey presented, although no reliable conclusions can be drawn.

## Findings

This section presents the facts and figures discovered through the survey, which will be covered in depth in the analysis section of this article (Appendix B). The 16 CNU students who took the survey included only juniors and seniors, primarily Caucasian, with ages ranging from 20 to 25 with a mean of 21 years of age. The sample for this survey contained 37.5% females and 62.5% males. The demographic figures of the preliminary alpha survey can be seen in Figure 1. The survey consisted of 17 questions, including a number of questions in order to conceal the true intentions of the survey from those providing answers in order to maintain its integrity. Thus, only 7 of the questions hold relevance for discussion. The first question asked, "What is your attitude towards tax evasion?" The vast majority of students felt tax evasion was unacceptable, in the amount of 87.5%. The other 12.5% were undecided on the issue.

Next, the respondents were asked, “Do you think your answer to the above question is in agreement with the majority of current college students?” This question received a unanimous “yes” from 93.75% of the participants while 6.25% chose not to answer this question. Then, the survey inquired, “How do you rate tax avoidance as one of the main ethical issues facing society today on a scale of one through ten, one being the most important and 10 being the least important?” The responses ranged from 2 to 8 and the mean answer received for this question was 5.07.

For Question 11, “Would a standardization of ethical procedures reduce tax code noncompliance?,” 18.75% did not tender a response, while 37.5% replied “yes” and the other 44.75% answered “no.” Question 12 holds relevance to this study, asking “Should there be a code of ethics for those who prepare income taxes?” All responded with an answer of “yes” in the amount of 93.75%, while 6.25% chose to remain unresponsive. Lastly, Question 14 asked, “Should everyone who prepares and files taxes follow the code of ethics proposed in question number 12?” Again, all those who chose to reply answered “yes” in the amount of 87.5% of the sample, with 12.5% declining to provide a response.

| Demographics | |
|---|---|
| Avg. Age | 21.3125 |
| % Junior | 43.75% |
| % Senior | 56.25% |
| % Female | 37.5% |
| % Male | 62.5% |
| % Caucasian | 87.50% |
| % Lebanese | 6.25% |
| % Native American | 6.25% |

Figure 1

| Age | |
|---|---|
| ages 15-19 | 25.5% |
| ages 20-24 | 66.3% |
| ages 25-29 | 2.0% |
| ages 30-34 | 1.0% |
| ages 35-39 | 3.1% |
| ages 40-44 | 1.0% |
| ages 45-49 | 1.0% |

Figure 2

The beta survey provided even more information than the previous preliminary alpha survey. The majority of participants, about 66.3%, were age 20 to 24, as seen in Figure 2. In addition, the sample was primarily undergraduate college students in the amount of 96.9% with the other 3.1% having obtained a college undergraduate degree. About 83.7% of the respondents were Caucasian, with the remaining 16.3% scattered across other races or ethnicities, as shown in Figure 3. Furthermore, 42.9% of the respondents were male and 57.1% were female. The first two questions of importance in this survey asked the respondent to define the terms tax evasion and tax avoidance. While a multitude of responses were received, most of these responses led to the same general conclusion that the two terms where similar in meaning. Also, the respondents were asked in question 3 “What is your attitude towards tax evasion?” The majority of respondents replied that tax evasion was definitely unacceptable, amounting to 60.3% of the participants, with 26.5% claiming tax evasion to be somewhat unacceptable. Question 4 asked “How would you rate tax avoidance as an ethical or unethical practice in society today?” The majority of the respondents felt tax avoidance was unethical, with 51.5% deeming the practice definitely unethical and 36.4% considering the act somewhat unethical.

The next section proposed statements, asking how each respondent agreed or disagreed on a Likert scale. To the statement "Those who prepare taxes should follow a code of ethics," most people strongly agreed in the amount of 78.7%. The statement "Those who prepare taxes should follow their own personal moral judgments," received a large portion of the responses in the "somewhat agree" and the "somewhat disagree" range, to the tune of 59%. Lastly, the statement "A combination of a code of ethics and moral judgments is necessary in ethical decision making when filing and preparing taxes," saw 49.2% strongly agree and 37.7% somewhat agree.

The last section of the beta survey contained a hypothetical question depicting a scenario in which an error on a previously filed tax report had been discovered personally. The question inquired as to which of six possible courses of action would be taken. The three most popular choices (each tied with 21.3%) were as follows: ignore it if you feel it will go unnoticed or fix it if you feel it will be noticed; fix the error because you feel that ethical taxpaying behavior is in the interest of the greater good of society; and fix the error because you would hope that everyone would do the same, as a universal law of sorts. Moreover, the option to "fix the error only if it will be in your favor" amounted to 18%; and the option to "correct the error no matter the cost in order to act lawfully" received 16.4% of the opinion.

| Race/Ethnicity | |
|---|---|
| Caucasian | 83.7% |
| African-American | 1.0% |
| Hispanic | 2.0% |
| Asian American | 4.1% |
| Other | 9.2% |

Figure 3

## Analysis

In this section, we will relate our survey findings to the article's main research question and hypothesis. The main goal of this is to show that our results indicate that there is, among college business students, a general misunderstanding of the problem of tax evasion, and that the application of our hypothesis would reduce this misunderstanding. This would, in turn, likely reduce the occurrence of unethical taxpaying behaviors. First, we observed that according to our question 6 of the survey, the majority of respondents felt that tax evasion was socially unacceptable. This result serves as an illustration of Kohlberg's sixth stage of moral development, universal ethical principles, in the third level of moral development, the post-conventional level. This implies that when faced with unethical behavior, most would agree that the only way to view tax evasion would be as unacceptable. This theory also applies to question 7, in which over 90% of respondents felt that their answer to question number 6 was in congruence with those of their peers. Question 7 could also be looked at in the third stage of Kohlberg's model, interpersonal conformity. This implies that people will act in accordance with what they believe will make them look the best in the eyes of those around them.

Another method of achieving our research goals was to show, through the survey responses, that the respondents have an insufficient understanding of tax evasion. This was done by including questions, such as numbers 8, 11, 12, and 14, which are meant to essentially trick the respondent into letting us know if they knew about the topic. Question number 8 concerns tax avoidance,

which in the context of the survey is seemingly interchangeable with the true topic of tax noncompliance. Given that there were answers at all, and because the mean answer to this question was 5.07, it can be assumed that the respondents were unaware of the difference between the perfectly legal practice of tax avoidance, ethically reducing the amount of taxes one must pay, and the illegal practice of tax evasion. This provides merit to our argument that many people are unaware of the unethical behaviors they may or may not be committing.

With questions 11, 12, and 14, we were attempting to show that a misunderstanding of moral development exists in regards to tax evasion. Question 11 asks if a standardization of ethical procedures would reduce tax evasion; in essence, it asks if universal ethical principles were to be established, as dictated by stage six of the Kohlberg model, would a reduction in unethical practices be observed? Those who possess knowledge of Kohlberg's theory would realize that this statement is most definitely true. Yet, the responses to this question showed no clear majority, with only 37.5% answering "yes."

Furthermore, the combination of questions 12 and 14 form a similar situation created by question 11; that is, the establishment of a code of ethics in tax preparation which must be followed by all who prepare and file taxes represents universal ethical principles. All those who answered questions 12 and 14 replied "yes." This creates a discrepancy, as questions 12 and 14 inquire to the same notion as question 11, Kohlberg's sixth stage or universal ethical principles. Thus, one can conclude that the respondents do not fully understand theories developed by Rest and Kohlberg. If people were made more aware of these issues, along with their own personal moral development, then tax code noncompliance would decrease, thus reducing unethical taxpaying behavior in general.

The beta survey found the same misunderstanding between the terms tax evasion and tax avoidance seen in the preliminary survey analysis. By and large, most respondents defined the two terms to be similar in meaning. The respondents are gravely mistaken; tax evasion is an illegal, unethical means of not paying taxes while tax avoidance is a legal, ethical means of reducing the amount of taxes one must pay. The misinterpretation of the two terms can be seen further in that 87.9% viewed tax avoidance unethical in one way or another. The respondents correctly deemed tax evasion unethical, with 86.8% believing so at least in some respects. Thus, one can conclude that the majority of persons understand tax evasion but do not understand tax avoidance or the entire situation of tax code noncompliance as a result.

Another interesting point of the beta survey is the Likert response portion of the "Ethics Applied" section. When asked separately, respondents generally agreed that a code of ethics should be followed by those who prepare taxes. Also, respondents more often than not believed that those who prepare taxes should follow their own personal moral judgments. It is peculiar to note that when the two aforementioned elements of a code of ethics and personal moral judgments were stated to both be necessary in ethical decision making, such as that of preparing and filing taxes, the large majority of respondents agreed to some degree. This presents an inconsistency issue, as the respondents disagree with one statement and then agree with the very next statement, which contains aspects of the former.

The last point of emphasis of the beta survey is the hypothetical question that asks how the respondent would act if an error were found on a previously filed tax report. Each of the six responses represented a single stage of Kohlberg's six stages of moral development theory. Three most popular responses correspond to stages one, five, and six, which are punishment avoidance, social contract, and universal ethical principles. Social contract is most closely defined as the greater good of society. Each of the six stages can be further split into three broader categories containing two successive stages apiece: pre-conventional, conventional, and post-conventional. The post-conventional stage is the adult way of thinking in terms of ethical decision making. Only 42.6% of the respondents to the beta survey were at the post-conventional stage, which contains stages five and six. This figure must change in order to achieve any sort of success in reducing unethical behaviors, let alone tax code noncompliance.

## Conclusion

Tax code noncompliance, or tax evasion, is undoubtedly an issue which largely concerns ethics and personal morality. With this problem being as prevalent as is it today, it is disconcerting to note which elements of society have caused it: an unchecked state of ignorance and misunderstanding of the tax code and tax law, as well as a seemingly low emphasis put upon ethics and moral standards. However, less alarming is the simplicity of a possible route for solutions. The present study provides concurrent survey results that show a lack of ethical, moral, and legal knowledge. More importantly, this study shows how this lack of knowledge relates to personal moral development, more specifically, the development and growth of moral judgment described by psychologists James Rest and Lawrence Kohlberg. Therefore, when taken from the personal level and applied to a societal degree, if societies are to put a stop to the growing trend of unethical taxpaying behaviors and ignorance of tax code and law, they must first and foremost instill, by whatever means necessary, the theories of Rest and Kohlberg.

Also, it is important to note that the results presented here are not claimed facts or infallible in nature, and flaws may exist. Something to take into consideration for future research would be that many of the respondents (38%) chose not to answer every question on our survey. We attempted to address this issue by creating our gamma survey, in which all of the questions required an answer. Unfortunately, conclusive evidence cannot be drawn, because only 7 people responded to this third survey. Another possibly flawed element could be that the application we used to distribute our beta survey limited our responses to 100. With a larger sample, our results could potentially provide for different analysis. We would have fixed this by not limiting our beta survey distribution to this online application. Limitations aside, our analysis ultimately suggests that these two paramount theories would play a significant and effective role in reducing unethical taxpaying behavior. Changes that we predict to happen, based on our findings, include an increased emphasis on moral judgment and moral development education. Only through this application of ethical and moral theory will the public become more aware of many unethical actions around them and adjust their moral judgments accordingly.

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# NON PROFIT AND FOR PROFIT BOARDS DOING SOCIAL ENTREPRENEUR PROJECTS: THE CHALLENGE FOR BUSINESS PROFESSIONALS

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Charles Matthews, University of Cincinnati
Nina Radojevich-Kelley, Metropolitan College of Denver
Harriet Stephenson, Seattle University
Rob Fuller, University of California-San Diego

Because many of us have business backgrounds and our institutions expect some community service, we increasingly find ourselves on both non profit and for profit board of directors. Both types of boards need talent, wisdom and dollars to survive. Once we find ourselves on these boards, what is expected of us? What problems or issues might we expect? What have others experienced that could be of help to the audience?

As federal and state funding decreases many non profits find themselves in a continual state of either fund raising or cash flow crises. Sometimes their desperate long term need is strategic planning; some need short term concerns of cash flow, inadequate accounting or tracking systems. All of them need the expertise of business professionals on their boards.

The current recession has many small for profits struggling. Conversations with the authors have found that many have experienced anywhere from 10 to 40% decline in their gross revenues. These situations require thoughtful and critical input from their boards to give them the direction they need through this downturn. What has happened during this recession to for profits and their desire to do social entrepreneur projects?

The assembled panel will go through some of their experiences both positive and negative and give some guidance to those who find themselves in similar circumstances.

# TEACHING ENTREPRENEURSHIP: TOP TEN IDEAS FOR TEACHING ENTREPRENEURSHIP COURSES INNOVATIVELY

Lynn Hoffman & Nina Radojevich-Kelley, Metropolitan State College of Denver

Over the past 25 years, few academic fields have experienced the kind of growth that entrepreneurship has seen. The number of colleges and universities offering programs in Entrepreneurship has increased to well over 3000. In fact, most leading schools offer majors, minors, certificates, or concentrations in entrepreneurship. With this surge of interest in the field, most institutions offer at least one entrepreneurship course.

The purpose of this workshop will be to examine top methods for teaching entrepreneurship courses innovatively, and creatively. Several schools, from those who have a few courses to those who offer full blown majors, will be examined and questioned regarding innovation in the classroom. We will provide suggestions, descriptions and a brief list of how to teach entrepreneurship students innovatively and creatively based on our findings. The audience will be asked to participate in a number of questions about teaching entrepreneurship courses innovatively / creatively and a discussion on best practices will be conducted.

The structure of the workshop will be as follows: a description of what it means to teach entrepreneurship courses innovatively/creatively and the importance of it. The pros and cons of teaching with innovation will be discussed. In addition, various institutions will be examined from an innovative teaching standpoint and shared with the audience.

The presenters will explain how various schools approach innovation and creativity in the classroom. Best practices will be discussed along with what has worked and not worked as far as innovation and creativity in an entrepreneurship course. We will provide a list of top 10 things we do to teach our entrepreneurship courses innovatively. In addition, we will answer some of the following questions and then ask the audience to provide some of their personal experiences with teaching. Furthermore, as a group we will brainstorm to try and find new ideas for teaching entrepreneurship creatively. The presenters will take notes during the discussion session and be willing to share the results via email.

After the introduction the questions for discussion will be:

1. How have each of you taught a Fundamentals of Entrepreneurship or an Introduction to Entrepreneurship course? Standard methods of teaching? How do you teach?
2. Is creativity and innovation important for the typical entrepreneurship student? Why?
3. Do you feel that innovation is important in the classroom? Why or why not? What are 5 benefits that students may gain from taking an entrepreneurship class that is taught creatively/innovatively?
4. What are some things that you have done to teach your entrepreneurship classes innovatively/creatively?
5. Have you tried to incorporate creativity into your classroom and it simply has not worked? WHY?

6. Why is it important to be creative as a professor? How will it benefit our students?
7. Do you feel that the way we teach our classes influence our students? Why or why not?

Brainstorm as a Group:

1. What are 10 new ideas for teaching entrepreneurship creatively?
2. What can we do better?

At the end of the workshop the presenters will summarize the information and provide a summary of suggested answers.

# CONSULTING WITH NON PROFITS AND FOR PROFITS ENGAGED IN SOCIAL ENTREPRENEURSHIP PROJECTS: ISSUES AND CHALLENGES

Joe Bell & John Hendon, University of Arkansas—Little Rock
Harriet Stephenson, Seattle University

The number of organizations engaged in social entrepreneurship has steadily increased over the last several years. Many of us and our SBI teams are engaged in attempting to consult and advise them. Their search for consultation and advice raises many issues.

Because the definition of social entrepreneurship is very broad with imprecise boundaries, the panel's topics will cover a number of issues. For the record there seems to be the following three separate possibilities: 1) they are not-for-profit organizations attempting to find alternative funding sources, 2) they are for-profit organizations doing cross sector partnerships (such as a developer and a city combining their talents to build a municipal golf course surrounded by housing, and 3) groups working to solve social problems and social transformation.

The panel members will discuss strategic planning aspects of the consulting process and how executives and boards can affect the consulting process. Another topic will examine how government agencies acting as not-for-profit entities are pursuing economic development. Some are acting on their own and many fit definition two above by partnering with for profits and other not-for-profits to encourage entrepreneurship. Some of the experiences from working with these organizations and their efforts will be discussed.

Some not-for-profits are moving into for-profit ventures. Their reasons are diverse and may include: volatile or declining funding, changing demographics, fewer succession candidates, loss of community advocates, a decline in volunteers with two career families, and the lack of community recognition and support.

This search for alternative and more stable funding creates unique challenges for consultants. Not-for-profits need advice in recognizing opportunities, feasibility analysis, financing, legal structure and other issues. These topics and other issues, experiences and missteps will be covered. The audience's suggestions and experiences will also be solicited.

# INNOVATIONS IN ENTREPRENEURSHIP EDUCATION

Shawn M Carraher, Cameron University
Howard Van Auken, Iowa State University

Howard Van Auken has been involved in entrepreneurship education at Iowa State University for about 20 years. ISU has been at the forefront of innovative program and course initiatives during this time period. Innovations include, for example, being one of the first universities in the US to offer a university-wide minor in entrepreneurship, initiating a campus-wide initiative to infusion entrepreneurship education in all colleges, and developing numerous courses.

His role in the proposed symposium will be to provide a brief historical perspective of the development entrepreneurship education at ISU, followed by a description of current program and curricular innovation. Innovation initiatives that will be shared at the symposium include:

- Recent revision of the university-wide minor in entrepreneurship that includes an experiential learning requirement for all students enrolled in the minor.
- Cross-campus initiative to teach entrepreneurship in all colleges.
- Entrepreneurship Learning Community
- Student owned and operated café
- International entrepreneurship initiatives
- College-specific entrepreneurship initiatives that include:
    - Development of Creativity Modules for Experiential Classrooms
    - Create a model for integrating entrepreneurship and construct curricular experiences that provide all students within a degree with the basic knowledge, tools, and foundational experiences to enable entrepreneurship in their careers in
    - Agricultural Engineering, Agricultural Systems Technology, and Industrial Technology.
    - Incorporating Entrepreneurship into Swine Veterinary Medicine Summer Internship Programs
- Creation of a graduate certificate in entrepreneurship
- Development of Student Learning Outcomes for the entrepreneurship minor

The resistance and risk, experiences associated with these initiatives, not unusual for innovation initiative, will be incorporated into the discussion. The discussion will encompass the strategies used in dealing with the resistance and risk challenges.

Shawn M. Carraher, the Brewczynki Endowed Chair at Cameron University, is Past President of the Small Business Institute® and has overseen international entrepreneurship research in 114 countries around the world with a focus on tourism and health care industries. He has also completed three Fulbright trips to teach and perform research in Eastern Europe. In his presentation Shawn shall about an innovative program in which he has taken the SBI model down to the Freshman level having Introduction to Business students completing SBI specialized mini-projects along with learning the basics of performing validation studies. He has now completed one decade of training Introduction to Business students with SBI projects and has directed over 400 SBI projects [from all levels] in the last 10 years.

# ACHIEVING CROSS-CAMPUS ENTREPRENEURSHIP BY BUILDING AN INTERDISCIPLINARY MINOR IN ENTREPRENEURSHIP

John Soper, Judith Brenneke & Jacqueline Schmidt, John Carroll University

Three years ago, a group of our faculty constructed the following definition of entrepreneurship:

> *Entrepreneurship is the exploration and risky pursuit of innovative ways to solve problems and to create value.*

This definition was arrived at by the Entrepreneurship Learning Community after lengthy study, discussion, and debate. The Entrepreneurship Curriculum Committee formed in the fall of 2007, began to build an entrepreneurship minor with this definition in mind, but also in the light of similar minors at a number of institutions including the University of North Carolina at Chapel Hill, Indiana University, Wake Forest University, Washington University in St. Louis, the University of Illinois at Urbana-Champaign, Syracuse University, and the University of Rochester. The academic legitimacy of entrepreneurship has been established at all of the institutions above, and it has blossomed as a field of study all over the U.S.

## The Need

For years, academic programs in entrepreneurship had a "business" focus. Programs were typically found in the Schools of Engineering or Business throughout the United States. Recently, a sea change began, prompted by a study commissioned by the Ewing Marion Kauffman Foundation. This study concluded that approximately 75% of all entrepreneurs were graduates of liberal arts and science programs, rather than graduates of business or engineering programs. Leading educators now look at entrepreneurship as a way of thinking, with a focus on launching new ventures and creating new opportunities in both the for-profit and the non-profit domains. This minor will equip our students with the tools they need to do so. We should recognize this understanding of entrepreneurship and provide our students, especially students majoring in the liberal arts and sciences, with an opportunity to acquire entrepreneurship skills and knowledge, while pursuing their majors in other fields.

## The Benefits

The interdisciplinary minor in Entrepreneurship will provide the following benefits:

1. To our students—the opportunity to challenge their thinking by encouraging them to expand their understanding of creativity, opportunity recognition, and the ability to act on these insights to form new ventures.

2. To the University—the ability to compete for new students who have an interest in entrepreneurship, as well as a major in another field. Two of our more formidable, near-by competitors for new students, both have excellent entrepreneurship programs with minors open to non-business students. In addition, the field of Social Entrepreneurship comports well with the mission of our as well as several on-going programs. Also, offering more options to current students and potential enrollees is desirable and necessary if we are to address an enrollment problem with any success.

3. To the College of Arts & Sciences—additional enrollment, both from new students, as above, but also potentially from students who might have chosen a major in the School of Business. In the latter case, if students have no other choice, they will select the SOB rather than a CAS major, even though they have a strong interest in a CAS major.

4. To the Faculty—an opportunity for faculty members to develop their own teaching units and courses in a new field with strong student interest. It may also provide faculty with the opportunity to connect their own discipline to entrepreneurship through their teaching or research.

## Goals of the Program

- To provide students, regardless of academic major, the opportunity to integrate and apply the principles of entrepreneurship as they pursue traditional academic majors
- To identify the connections between traditional academic majors in the liberal arts and sciences or business with entrepreneurship
- To integrate the structures and functions of basic organizational practices, such as project planning, accounting, marketing, finance, production, and evaluation, with entrepreneurial practices
- To instill and develop the habits of mind characteristic of entrepreneurial thinking; including innovation, problem-identification and problem-solving, idea development, and an orientation towards action and venture development
- To evaluate the similarities and differences between for-profit and not-for-profit entrepreneurship with a particular focus on the emerging field of social entrepreneurship

## Structure of the Program

The Entrepreneurship Curriculum Committee (ECC) was formed early in the fall of 2007 by the school of business, and met throughout the year to develop a proposal for a minor in Entrepreneurship. After a slow, but steady process, this proposal was approved by (a) the deans of both the school of business and the college of arts & sciences; (b) the university curriculum committee; and (c) the entire faculty. Note that the final approval of the faculty won by a 10-to-1 vote! This minor is now open to all undergraduates, regardless of major.

The minor has two tracks, one for students planning on a major in the college of arts & sciences and another for students planning on a major in the school of business. As appropriate, the first four courses may be taught by faculty of either the CAS or the SOB, and are designed to fit neatly into the freshman and sophomore years, with some shorter courses (less than 3 credit hours) that can be used to "fill out" the student's schedule.

As students approach the junior year, and declare a major, they can continue in the minor by choosing either the Arts & Sciences emphasis or the Business emphasis. We expect that the overwhelming majority of these students will continue in their major of first choice. The upper-level courses in the minor sequence will, with team-taught Marketing, Accounting and Finance courses, give students a basic understanding of a complex organization.

## Staffing and Resource Requirements

The ECC believes that the courses in the minor in Entrepreneurship can be taught by teams or individuals who are already members of the JCU faculty. The Committee foresees that the holder of our Chair in Entrepreneurship will be assisted by faculty from both the business school and the college of arts and sciences. To assist faculty in the process, a special, week-long Faculty Development Workshop was conducted in May 2008. There were 21 participants in the FDW, and 12 of these were CAS faculty members. This FDW featured two nationally renowned entrepreneurship educators: Dr. Donald Kuratko of Indiana University and Dr. Jeffrey Cornwall of Belmont University. In addition, a half-day "Seminar on Entrepreneurship for Liberal Arts & Business," was held at a country club for 22 participants, five of whom were not participants in the May FDW (four out of the five were CAS faculty members). A further faculty development program was conducted in the spring and summer of 2009 with a carefully selected group of eleven Faculty Fellows in order to facilitate the implementation of the Interdisciplinary Minor in Entrepreneurship.

After assembling a "critical mass" of faculty champions for the minor, we proceeded to vet the minor with our academic deans and other administrators. The deans of CAS and the SOB have both stated their willingness to support the program and the chairs of the affected departments have also agreed to lend their support.

## Administration of the Minor in Entrepreneurship

The minor will be administered by our Chair in Entrepreneurship, with policy oversight provided by a permanent Entrepreneurship Curriculum Committee. This permanent ECC has faculty from both the business school and the college of arts & sciences, and is chaired by the holder of the endowed chair.

# PROVEN INTERACTIVE METHODS FOR TEACHING ENTREPRENEURSHIP IN CHINA

Gerry Murak, Murak & Associates LLC

## Abstract

In order for students to gain a greater appreciation of entrepreneurship, it is important to create a process which is as realistic as possible. This challenge is compounded when teaching entrepreneurship in another country. Having been given the challenge, honor and opportunity to teach entrepreneurship in an Executive MBA Program in Beijing, China for three different class years, techniques were developed with demonstrated results.

It's one thing to get high ratings in a class evaluation, but the greatest compliment of the effectiveness of teaching entrepreneurship, is when several students, who have very significant jobs in large corporations or State Owned Enterprises (SOEs), start their own company. Within one year of the completion of this program, eight of the forty executives in the EMBA class left their corporate positions and formed a new enterprise. Similar results were achieved in utilizing the same curriculum on two other occasions in China.

## Foundation

This EMBA Entrepreneurship Class contained twenty modules which had corresponding reading assignments and case studies. Modules covered were: The Entrepreneurial Explosion, The Entrepreneurial Process, Identifying the Entrepreneurial Opportunity, The Role of the Internet in Entrepreneurship, The Entrepreneur's Mind, Forming a New Venture Team, Ethics, Determining Resource Requirements, Elements of a Business Plan, Entrepreneurial Finance, Obtaining Capital, Making the Deal, Obtaining Working Capital, How to Manage Rapid Growth, How to Prevent Getting in Trouble, the Dot "Gone" Era, How to Turn Around a Troubled Venture, Exit Strategies and Family Business Issues.

## Passion

Although the foundational reading and case study discussions were important, they would not be real to their individual world. During the first flight to China, there was plenty of time to think through how the heart of entrepreneurship, "passion", would be communicated and understood in another culture. So I coined the expression, "What Makes Your Mind Smile?℠".

During the very first class, each student was asked to think about, "What made their mind smile?℠" and then to individually commit that thought to paper. To help this process, they were asked to consider challenges in life that had meaning to them, or to examine ideas that they had to create or improve products, services, businesses or non-profits. Basically, how could they take problems they had come to know in their business or personal life and turn those into opportunities in order to create new ventures?

During the second session, each student then had to present their result of their self- discovery process to the rest of their EMBA class. Following their brief presentation, the rest of the class was afforded the opportunity to probe and challenge each presenter's idea to see if the concept for a new venture was, in fact, genuine. Through this process, each "wanna-be" entrepreneur student quickly learned the strength of their convictions. It is tough to fool thirty-nine peers in your class.

## Formation

During the third module, the students were asked to identify which key functional responsibility in a corporation best fit their interests and strengths, e.g. CEO/Leader, Finance/Information Technology, Marketing/Sales, Operations/Quality and Human Resources. The eight students, who had a strong desire to be the "CEO" or leader of an entrepreneurial venture, became the team leaders for the class business plan project.

Given the results of this self-selection by functional area, the "CEOs" were instructed to mini-interview their classmates and then, through a rotation, pick the remaining four team members that represented the key roles of their new venture.

The team was then given an opportunity to again discuss their first assignment regarding "passion", but this time within their newly formed "company". The team then had to determine which of these entrepreneurial ideas would be the focus of their business plan for a new venture. This caused each student to be even more convincing to their teammates that their new idea was the best of the five ideas shared in their team.

## Responsibilities

Part Two of the team assignment was to divide up the business plan by functional role. The Marketing/Sales Manager had to define the product/service, the target markets and current competition. The Operations/Quality Manager had to determine the capital needs, as well as the metrics, to measure internal quality and customer/consumer satisfaction. The Finance/IT Manager had to create the financial projections and the role of IT. The Human Resources Manager had to put together the "A Team" and people plan, as well as make certain the business plan succinctly communicated the attributes of their Team. The CEO was responsible for making sure that there was continuity between each of the elements of the business plan as well as to compose the executive summary.

## Presentation

Each team was then given a random draw date for their business plan presentation. The business plan document had to be provided to me, the instructor, one week prior to the presentation. They also had to provide the class with a PowerPoint presentation. Each team member had approximately five minutes to present their own section of the business plan from the perspective of their functional role. The half-hour business plan presentation was then followed by approximately ten minutes of questions and answers.

## Reaction

During the team business plan presentations, the balance of the class was informed at the onset of the class that they would be role playing as potential hires and investors to each new company. To quantify their position, each student was supplied with a simple half page rating sheet (see the attachment) which identified the team's name and business concept. The rating sheet consisted of four questions: "Would you join the business?" 1 = no, 5 & 6 = not sure, and 10 = yes. Each reactor had to circle a single number from the scale of 1 – 10. The second question was, "What is the reason for your response?" The third question was, "Would you invest in this business venture?" The same scale was used as in question 1. Question 4 was, "What is the reason for your response to investing in this business?"

Each reactor had to sign off on their rating of the presenting team. The ratings were compiled so that each team could see the results given by their peers that were acting as reactors. At the end of the semester, each team was not only provided with the quantifiable results from their classmates, but also a random and anonymous listing of their comments.

## Feedback

The reactor forms truly serve as a feedback mechanism which helped the presenting teams to gain further insight into what it would take to attract key people to their team as well as attract potential investors. The written comments cause the teams to polish their plan should they have a true desire to someday become an entrepreneur.

## Summary

When a curriculum in entrepreneurship needs to be designed for an Executive MBA Program, the challenge of creating reality in a compressed timeframe can be overcome by emulating the entrepreneurial experience from idea to plan presentation. It is also further validated by the ratings from their peers, which allow them to see whether or not their new venture idea would attract key employees and investment.

Nothing was more rewarding than getting feedback from the students that they followed their passion and formed a new venture. In this new economy the world faces today, nothing is more important than job creation through new business ventures which are based on a solid foundation of passion, which converts today's problems into tomorrow's opportunities.

# MASTERS OF SCIENCE IN STRATEGIC BUSINESS TRANSITIONS

William A. Andrews, Stetson University

## Introduction

For almost a decade, I have directed our university's entrepreneurship program while being a member of three professional associations in related fields: venture capital, mergers and acquisitions, and managerial finance. I began to suspect a gap existed between our university's graduate entrepreneurship and business curriculum and the actual practice of high-growth entrepreneurship. After discussing a curricular concept with a partner of a large venture capital firm in Atlanta, the partner gazed out the window and said almost wistfully, "It costs me $40 million to train someone in venture capital." He assured me that anything that academe could to do reduce that cost would be appreciated.

What followed was a research effort that involved talking with other VC and private equity (PE) partners to assess their view of what knowledge and skills were needed to work in their respective industries, and which skills seemed to be in short supply (see Appendix A - Summary of Findings). During these discussions, it became apparent that most of the skills and knowledge-sets mentioned were equally relevant to entrepreneurs of high-growth businesses. As the curriculum details began to come into focus through these conversations, it became apparent that a MS degree would give us more flexibility than an MBA. A review of MS degrees currently being offered in entrepreneurship and finance was conducted. The review suggested that some of our courses appeared in both MS programs, some in only one, and some in neither. Most of those course falling into the "neither" category were commonly found in in-house training programs of large law firms, accounting firms or investment banks. Moreover, the findings suggested that the deficiencies I had first suspected in our own curriculum were in fact evident in many other schools' curricula. The diagram below summarizes what we found, and illustrates what we endeavored to do with our curriculum: to merge aspects of these three curricula into a single niche program that would serve the following audiences:

- helping entrepreneurs understand the details of private finance and the related legal, accounting and investment banking dimensions to be considered when starting a high-growth business.
- helping the investor community understand the operational, legal, and accounting dimensions of growing and funding a business.
- helping those in the professional service fields (law, accounting,) to understand operational, valuation, and financing aspects of high-growth businesses

The next difficulty was to determine a name for the program that would best describe it. We considered "MS in Entrepreneurship, Venture Capital , and Private Equity" and "MS in Entrepreneurship and Private Finance" before deciding on "MS in Strategic Business Initiatives". It was felt that the latter name implied "entrepreneurship" while avoiding the oft-associated connotations of "small" and "new". Moreover, by not having "entrepreneurship" in the name, we would not invoke a biased mental frame about what the curriculum entailed from those familiar with entrepreneurship curricula.

## Program Distinctives

The program distinguishes itself from related MS programs on three dimensions: curriculum, faculty, and delivery.

*Curriculum*

The curriculum is divided into three types of courses: Core, Skill, and Situational.
Four 3-hour courses form the Core: Financial Modeling, Launching the High-Growth Company, Private Equity and Venture Capital: Investing Criteria and Firm Management, and Operating and Strategic Challenges. A detailed description of each is provided below. These courses are the ones most commonly taught in other Finance or Entrepreneurship MS programs. Each is three credit-hours.

Skill courses are very narrowly focused, often found in professional service firms' training programs and often missing from degreed programs. All but two are one credit-hour. The curriculum includes 10 such courses covering 12 credit-hours. While the full list is shown below, examples of Skill courses include Business Valuation; Commercial, Mezzanine, and Asset Based Lending; and Due Diligence

Situational courses include seminars on the state of the industry or economy with respect to new technologies, financial conditions, secular trends, etc., with a view to assessing emerging opportunities or threats. Also included as a Situational Course is the opportunity for either a significant project or internship. Situational courses will vary in theme depending on what is timely and relevant. Six hours of situational courses are required. Examples of relevant situational courses at the time of this writing include Biotech Start-up and Investing and Opportunities in Bankruptcy and Distressed Asset Investing. Each seminar anticipates a panel of industry participants and practitioners as the content-experts.

*Faculty*

Core classes will be taught by our regular faculty, with the exception of the modeling course which is entirely online. The Skill Courses and Situational Seminars will be delivered by practicing professionals, with testing events, casework, and course grading handled by regular academically-qualified faculty. The 12 hours of Skill Course modules will be grouped into sets of three hours, with one academically-qualified professor supervising the grading for that set. Parenthetically, one set of courses will count as a 1 FTE for staffing and budgeting purposes. The presenters will be paid as guest lecturers. This staffing model allows students to learn from the deep insights and experiences of the practicing community, while ensuring that the Business School does not run afoul of its AACSB accreditation.

*Delivery*

The delivery has both asynchronous and synchronous components, allowing the typically-busy masters student the benefits of both time flexibility for mastering the content (asynchronous) and face-to-face classroom interaction to refine their judgment. In general, the content from the professionals will be available online in asynchronous format, and will be viewed in time to complete assignments and otherwise prepare for the in-class "synchronous" sessions. It is further anticipated that the professionals will visit the class for least one session during the module in which the present asynchronously.

*Sequencing*

The curriculum is designed to be completed on a part-time basis in 15 months. The students must take and complete the Financial Modeling course online before being allowed to take other courses. The program may be entered at any time, but regular coursework will begin at the start of the semester after the Financial Modeling course has been completed.

## Current Status

The curriculum is moving through the approval channels at the University. Inasmuch as Stetson University has both a new president and provost as of four months ago, the approval of new programs has largely been put on hold while a university-wide review of existing programs is conducted. The Association of Mergers and Acquisitions Advisors (AMAA) has expressed interest in co-branding the degree with us and furnishing some of the Skill Course modules. Several attorneys from major law firms represented at the Florida Venture Forum (the largest VC association east of the Mississippi) also expressed strong interest in participating as instructors. The leadership of the local chapter of the Young Presidents Club has reviewed the curriculum and is enthusiastic about its relevance to its membership.

# REQUIRING MULTIMEDIA IN STUDENT RESEARCH PROJECTS

Diane Campbell & Radha Chaganti, Rider University

We introduced a multimedia student research project into the new course ENT 375: International Entrepreneurship. This course is being offered to Rider University's business students starting Fall 2009. This course seeks to provide an understanding of the reasoning why entrepreneurs should do business abroad, and an insight into the environment existing for entrepreneurship in the BRIC [Brazil, Russia, India and China] countries.

One major component of this course is the multimedia research project requirement. Student teams select a BRIC country and research its 1) Economic and Cultural Profile and 2) Entrepreneurship Profile, and make a multimedia presentation of results to the class. This multimedia research project would include short videos, music, commercials, etc. but would not require original production of videos or music. In addition to the project, concepts and cases on internationalization for small and medium enterprises are covered in this course.

A key objective of this project is to make learning highly participatory because students will learn in greater depth and retain much more when they gather, analyze and present information in multiple media. We hope using multiple media to understand a different country will also bring them closer to understanding 'realistically' the environment experienced by that country's entrepreneurs. Also, multimedia will allow students in class to visualize immediately the differences across various cultures that could not be demonstrated as well with the simple facts being delivered in PowerPoint. Multimedia learning is also in line with how current-day students experience their environment.

In order to assign a multimedia project, we needed a different approach in preparing to teach this course. The two of us, namely, the course instructor and a business librarian experienced in finding multimedia resources, needed to engage in continuous collaboration at the design stage as well as during the semester in guiding students in the research project. One challenge was adding this course with no increase in funding for multimedia resources. As a result, the librarian had to develop a research plan that relied on free web resources as well as the existing business databases. A wiki with links and instructions on use is being developed and the business librarian will instruct the class on finding all the necessary information and artifacts. Further, students are expected to work regularly with the business librarian during the semester and some class time will be allocated for troubleshooting the research project. This course will be taught over the coming months of Fall semester.

The project presentations will be evaluated by both of us and student responses will also be collected. An assessment of the experience and lessons for the future will be shared at the Conference.

# ENGAGING THE ENTIRE UNIVERSITY AND COMMUNITY IN CHANGE WHICH PROMOTES THE BENEFITS OF ENTREPRENEURSHIP: THE STORY OF A UNIVERSITY'S NEW CENTER FOR SERVICE LEARNING AND SOCIAL ENTREPRENEURSHIP

Roberta Rosenberg, Patrick Walker & Stephanie Bardwell, Christopher Newport University

## Abstract

This Best Practices submission describes the implementation by a small public liberal arts university of an innovative program which blends business, liberal arts, social entrepreneurship and civic engagement to achieve academic and social justice and economic goals for students and faculty, community and university. The key factors to succeed are described; these include goal setting, moving from the ideal to the practical, setting and meeting deadlines, leveraging support and celebrating success.

## Statement of the Best Practice Method Used to Achieve the Outcome

Change implementation at most universities, particularly academic curricular change, is notoriously slow. The standard waiting period from "new idea concept" to published "catalogue change" at most accredited universities is one year or more. In the case of Christopher Newport University, the combined efforts of a multi-disciplinary faculty group, student and administrative leadership and community "buy-in" were leveraged to design, develop, approve and open the Center for Service Learning and Social Entrepreneurship within one year.

## Background and Environmental Issues

The steps for successful change were orderly and well-planned. A small committee of faculty was formed to propose and develop a new minor suitable for all students which captured the mission of the university and acknowledged the limitations and characteristics of the students, faculty and programs. Undergraduate and graduate programs at Christopher Newport University include more than 80 academic majors and programs, ranging from accounting to theater arts, management to social work. Our approximately 5,000 students come from every region in Virginia, 25 other states, and 30 foreign nations.

The spirit of the university and active leadership of our administration created the perfect opportunity to propose a new program to embody the stated "vision" of Christopher Newport University. Our official "Vision" was a central element in the argument for change: "Christopher Newport University, a small academically selective public university, is grounded in the principles of liberal learning and dedicated to the ideals of scholarship, leadership and service.

Administrative support and leadership is instrumental in achieving academic programmatic change. Our University President, Paul S. Trible, Jr. has directed and motivated significant quality change from the onset of his tenure as President. Trible has overseen significant improvements in the academic programs offered at CNU and is committed to providing a high-quality liberal arts education that stimulates intellectual inquiry and fosters social and civic engagement.

## Goal Setting

Creating synergies and identifying common goals is essential for project success. A small faculty committee [four persons] was organized; it consisted of faculty from three key disciplines, Business, English and Social Work. This faculty group met regularly to create a general description of the project goals; these goals included courses, activities and the basic design of an inter-disciplinary curriculum. Paramount in this design was the theme of curricular rigor, integrity and diversity as well as civic engagement opportunities to benefit both students and community. Review of well-respected programs in place at NYU and George Mason University was included to avoid having to re-invent the wheel at the curricular level. Each meeting of this faculty group entailed detailed note-taking and discussion of the accomplishments to date with members of the group. At key points, the benchmarking activities were summarized and sent as an FYI Memo to the administration. Feedback from the administration at this early stage prevented late stage disappointment and this goal setting and benchmarking process is a "Best Practice" we highly recommend.

## Moving from the Idealist Phase to the Practical Phase

As academics, we wanted to create the "Ideal" program using every possible highly touted feature of programs in place at NYU and George Mason. We desired our students to experience the best possible programmatic classroom teaching, the best possible field experiences, the best possible reflective opportunities, and the best possible applied civic engagement improvement activities that would create tremendous economic, social and community benefits. This idealism included execution of curricular submissions for new courses, proposals for intensive field based externships with high hourly requirements and one-on-one mentorship duties for each externship or internship related to the minor. The developmental phase, pre-execution, was consuming, sometimes contentious, and often humorous. This phase fortunately morphed rapidly into a practical approach; the practical phase of the development was aided by the expert guidance of experienced members of the committee. Thus the committee was able to take full advantage of the voice of experience and abide by the central value for successful committee work.

## Leveraging Support

A key factor in developing and combining community support with university resources is to invite third party participation by seeking joint partnerships to achieve mutual benefits. An explicit example of this approach can be achieved by selective grant seeking; this is another feature we recommend as a best practice. For example, our Director of the Center for Service Learning and Social Entrepreneurship has successfully won grants by producing workshops teaching others how to achieve programmatic success. Sharing successful techniques with others is a highly beneficial Best Practice.

## Conclusion

It is sometimes hard to realize that practical and effective change can spring from the efforts of motivated and caring individuals who dare to dream. With the Best Practices described in this descriptive journey about inter-disciplinary civic engagement and social entrepreneurship, perhaps more Universities will embrace change. Visit http://service.cnu.edu to see how effective a website that appreciates and celebrates a program can be designed.