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THE ENTREPRENEURIAL EXECUTIVE

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LETTER FROM THE PUBLISHERS

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IS WAL-MART SMOTHERING SMALL TOWN AMERICA?

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ABSTRACT

Everywhere there is evidence of new establishments being built. It seems that cities are now reaching out further and small towns growing up over night. Some call it progress; others call it sprawl. One of the most recognizable faces popping up in the new development is the brainchild of Sam Walton, the founder of Wal-Mart. New Wal-Marts are being constructed as currently estimated at the rate of one a day. These superstores invite strong feelings pro and con and the effect of their presence is much debated. The purpose of this paper is to examine the effects of the discount superstore entering into a community.

INTRODUCTION

Is Wal-Mart an example of the great American dream or a small town nightmare? It is difficult to travel far without finding a Wal-Mart looming on the horizon bustling with shoppers scrounging to save money. Founded in 1962 in Bentonville, Arkansas by entrepreneur Sam Walton, Wal-Mart has grown into a commercial superpower offering products and services in a one-stop shopping format that may include: automotive service, banking, fast food, optometry, photography, and hair and nail salons. Wal-Mart provides low-cost shopping for the cash- strapped consumer. However, the question continues as to whether the end result is positive or negative when Wal-Mart locates a store, which can sometimes be over 200,000 square feet, on the edge of town.

Proponents of the mega-superstore cite the creation of new jobs, lower-priced goods and increased city revenue as benefits. However, many people in the communities are convinced its presence will have negative effects on the smaller, existing community "mom and pop" stores, and lead to the dissolution of a unique small-town atmosphere. Studies as to the effects of introduction of big-box retailers, those with merchandising establishments over 100,000 square feet, have been conducted in various regions with conflicting results. This study will analyze those previous studies and also the various viewpoints for and against the introduction of large discount superpowers into a community. Emphasis will be placed on the introduction of Wal-Mart as it is currently the United States' largest retail establishment. There will also be some discussion as to how currently operating small businesses can perhaps adapt to doing business in the shadow of the giant.

LITERATURE REVIEW

The debate about large retail establishments entering communities is not a new one. Authors have been discussing this issue for almost forty years. "Reactions of a Small Town to a Rumored Discount House," was written in 1965 with many of the same arguments regarding Sears and A&P that are now being voiced about Wal-Mart.

Kenneth Stone researched the introduction of Wal-Marts into Iowa, with data collected on the resulting impact on the host town, non-Wal-Mart towns, cities and small towns. The most comprehensive study done regarding the effect of a discount superstore is "Impact of Wal-Mart Stores on Iowa Communities: 1983-1993."

> *"The premise of the study is that in areas of somewhat static population (such as in states like Iowa) the size of the retail 'pie' is relatively fixed in size for a geographical area. Consequently, when a well-known national chain like Wal-Mart opens a large store in a comparatively small town, it invariably will capture a substantial slice of the retail pie. The end result is that other merchants in the area will have to make do with smaller slices of the retail pie, or get out of business. In areas of the country where the population is growing rapidly, there is room for more retail establishments and the effect will be diluted considerably"* (Stone, 1995).

Unsurprisingly, Stone's findings support the argument that the introduction of a Wal-Mart into a town has a negative impact on already existing businesses resulting in the demise of the pre-existing businesses. Statistical information for the years 1983-1993 such as sales dollars for each retail arena was gathered, analyzed, and compared to pre-Wal-Mart conditions. On a positive note, there was an increase in retail trade due to the Wal-Mart drawing shoppers from nearby towns. Businesses selling merchandise that differed from Wal-Mart's selection usually experienced a slight increase in sales due to a spillover effect but stores competing with Wal-Mart typically experienced a decrease in sales. Neighboring towns that did not have a Wal-Mart experienced decreased sales in nearly all areas except dining. Overall the study reported a change in the shopping habits in consumers, moving from local merchants to discount merchandisers, resulting in the loss of many stores across the state. According to the results of the Stone study of Iowa and the study conducted in the Northeast, there may regional differences in the impact of a Wal-Mart opening. Of the categories of retail studied - building materials, general merchandise, food, auto supplies, apparel, home furnishings, eating and drinking, and drug stores - several had different results.

Barnes, Connell, Hermenegildo, and Mattson (1996) studied the regional impact of introduction of Wal-Mart in the Northeast. The Northeast study cites difference in the results when compared to the Iowa report. Results of the northeast study did not mimic the very negative impact of the reported effects on Iowa. A year after the Wal-Mart introduction, almost every industry reported the number of retail establishments remained constant. The authors of the study contribute these positive results to differences between the two regions such as the population density of the areas studied. The Northeast has a greater population density and the geographical areas studied already hosted a large number of retail outlets that may account for the dilution of the impact expected for the opening of Wal-Mart. The authors also note that the Northeast has had a large consumer opposition to Wal-Mart in recent years and the heightened awareness may have negated the novelty attraction of the new store that other areas may face (Barnes et al., 1996).

Forty years ago, McNeal (1965) was researching the same subject, fears about the impact of Sears & Roebuck and A&P on small towns. The debate about large retail establishments entering communities is not new. Today thee is concern regarding Wal-Mart where in the past there was much to-do over such establishments as Sears and A&P. During the research of this paper, an article surfaced entitled "reactions of a Small Town to a Rumored Discount House," written in 1965. It appears that much of the sentiments expressed by the research subjects in this previous paper, including the reactions of retailers as well as consumers, are still some of the same sentiments described today.

A third study, the Shils report, touches on not only the economic but also the sociological impact that the discount chain may have on small businesses in communities. The majority of the report echoes the study done by Stone regarding the decrease in the number of retail establishments in the areas. It supports the thesis that such mega-retail discount chains have an overall negative impact on the area by citing sociological effects perceived to have occurred since the opening of such a store. Shils goes as far as to declare that a loss of retail stores creates "social instability."

COMPETITIVE ADVANTAGE

The main concern of those opposed to the introduction of a Wal-Mart or other discount superstore is the effect on existing businesses in the community. Category killers are another type of large retailer, described as such because they specialize in one type of product and usually obliterate the competition. Wal-Mart and other national enterprises involve such large networks of stores that the buying power they have in the industry is unmatched. Wal-Mart does not solicit vendors; they solicit Wal-Mart. The financial advantage for manufacturers with a relationship with the super-giant is remarkable. Wal-Mart has such power that they can make demands for products designed specifically for their retail establishments.

Since Wal-Mart is the world's largest retailer of music merchandise, their desires quickly become reality. When Wal-Mart wants artists to produce alternate versions of their albums with cleaner lyrics, the record companies comply. (Peled, 2001). This demand is causing a rift in the industry. For example Wal-Mart demands cheap DVDs which Universal is unwilling to create for fear of damaging the profitable rental business. Meanwhile Warner obliges with its high-volume, low-margin approach. Tandy Brands Accessories sell 39% of its total sales to Wal-Mart; Clorox sells 23% of its total sales to Wal-Mart. In a study by Useem, Schlosser, and Kim, "One Nation under Wal-Mart," they describe the manufacturing executive's trip to Bentonville to close a deal with Wal-Mart. They state, "there are two types of executives these days: those who have learned to play by Wal-Mart's rules, and those who still haven't learned the right answer to … 'Who's No. 1?'" (Useem, Schlosser, and Kim, 2003)

So can the small business compete in the shadow of a retailer that has the power to set their own price? "Industries that sell commodity products - which are as diverse as drugstores and lumber retailing - have been quick to fall to superstores, notes Dun & Bradstreet's David Kresge" (Ehrenfeld, 1995). Still, some companies have chosen to maintain direct competition with "big-box" retailers. In the attempt to be able to offer comparable prices, many have formed purchasing collectives to be able to purchase larger quantities than possible independently and receive larger discounts. Two of these collectives are the hardware alliances Cotter & Co. and Ace Hardware Corp. These purchasing arrangements have helped some stay competitive (McCuine, 1994).

Although some companies have continued to thrive against Wal-Mart including Dollar General and Save-A-Lot, experts unsurprisingly suggest avoiding direct competition. Dollar General and Save-A-Lot have been able to survive based on low overhead costs; the stores are usually around 6,000 square feet and use palletized displays rather than shelving. They generally carry one brand of an item and use opportunistic purchasing to sometimes beat Wal-Mart pricing (Barron, 1999). Faced with a Wal-Mart or category killer, local retailers have few choices: lost revenues and possibly failure or adaptation and co-existence. Experts recommend differentiation when it comes to competing with a large discount store. Businesses must offer specialty items not carried by the larger businesses or emphasize something that will create a niche market. Customer service and expertise are two of these areas. Faced with a Home Depot in the area, Joe Waksler, owner of a local hardware store employed these methods. He stocks more items per square foot in his 5,000 square foot store because he is able to purchase oddball items not feasible for the big retailer, who buys in volume (White, 2001). Nurseries are also very successful in competition with discounters by specializing in rare or exotic items not carried in superstore garden departments.

Now more and more industries are feeling the pressure from Wal-Mart. Most recently gas stations have found themselves pitted against the sales giant. People are very willing to trade convenience for price. By 2003, over 700 Wal-Marts had gas stations, pumping over one million gallons a day (Useem, Schlosser, & Kim, 2003). As Wal-Mart expands its services, more areas are feeling the pressure.

The issue of the growing rate of Wal-Marts is also a concern when competition is in danger of being eliminated. Many believe that Wal-Mart practices a saturation policy, placing several stores impractically close together to drive out competition. Sam Walton grew his empire by placing large stores in under-served areas. However, today, Wal-Marts are often placed less than 20 miles apart. CEO Lee Scott describes the expansion of Wal-Mart: "We've found that a smaller population than what we originally had thought can support a Supercenter. So you can put two Supercenters - Rogers (Ark.) and Fayetteville - roughly four miles apart. Same thing is true in Dallas, Houston, and Atlanta." And within those four miles Wal-Mart is building new Neighborhood Markets or "Small-Marts" (Useem, Schlosser, & Kim, 2003). Once saturation has eliminated the competition, the least profitable stores are then shut down. In 2002, there were 350 abandoned Wal-Marts in the United States (Jacobus, 2002). This has been referred to as a scorched earth policy of retailing (McCuine, 1994). Some business analysts can not resist expressing sentiment while retaining a business perspective. Michael LaFaive is quoted as saying, "While it can be heartbreaking to personally see small, family-owned businesses get 'crowded out' by the big boys, a proper economic analysis must consider productivity increases in net terms. To this end, it is important to remember that the successes of megastores like K-Mart or Staples is based on the voluntary association of consumers" (1997).

SPILLOVER EFFECT

While businesses in direct competition with discount warehouses do not generally fare well, the introduction of large retailers actually increase sales in unrelated firms such as restaurants due to a spillover effect. In the Stone study, eating and drinking establishments in the Wal-Mart towns grew faster than the state average. People living in a town without a Wal-Mart are traveling to shop at the Wal-Mart towns and consequently dining there. There was a corresponding decrease in sales for eating and drinking establishments in nearby non-Wal-mart towns. Stone attributes the increase in sales in home furnishing stores to the spillover effect as well, since Wal-Mart has a limited selection of these items.

MIXED REACTIONS

Reactions by a community to the announcement of a discount superstore vary from one extreme to the other. In Bristol, Tennessee the town council attempted to sue the townspeople lobbying to block the construction of a Wal-Mart on the grounds of the lost revenues that would be generated by the store.

Many residents support the construction of Wal-Mart because of the low prices offered and the variety of products readily available at the one-stop shop. It is very appealing to think you can get your oil changed and a new car loan all in the same 30 minutes. "The average Wal-Mart carries between 60,000 and 75,000 SKUs (Stock Keeping Units)…The number of SKUs is used to measure the number of individual items carried by a store" (Clarkin, 1998). Wal-Marts are especially attractive to the low income individuals residing in the town. In the 1965 study McNeal found that 85 percent of the consumers were in favor of a new establishment that would offer lower prices. The crowded parking lots at local Wal-Marts are often filled to capacity, demonstrating that the enthusiasm for lower priced merchandise overrides the opposition. While there are concerns among the public for the welfare of existing merchants, the individual's strongest commitment is more personally related to their own budget. Wal-Mart's low pricing has actually been recognized for helping the United States economy.

> *"Wal-Mart has begun to generate an economy-wide Wal-Mart effect. Economists now credit the company's Everyday Low Prices with contributing to Everyday Low Inflation, meaning that all Americans - even members of Whirl-Mart, a ritual resistance group that silently pushes empty carts through the superstores - unknowingly benefit from the retailer's clout ... 'You add it all up,' says Warren Buffet, 'and they have contributed to the financial well-being of the American public more than any institution I can think of'"* (Useem, Schlosser, & Kim, 2003).

Wal-Mart and large retail establishments also provide more revenue to the community in the form of sales taxes gained from the sale of goods, as well as property taxes that would be paid by the store. According to Stone's study, general merchandise sales in a town hosting a Wal-Mart increased 53.6 percent on average after the first year of the opening. The increase in sales spawns new revenue for the town which can be used at the discretion of the city council. Another example of the benefits of introducing a big-box retailer is the case of the redevelopment of St. Anthony Village, Minnesota. In an effort to revitalize the town's retail district, it was proposed by a city planner to introduce a big-box retailer. At first opposed to the idea for fear of losing the small town identity, the project became a reality when it was estimated that the current property tax of $370,000 would shoot to $2.5 million with the increase in property value (Werner, 2003).

Those against the developments cite several reasons for their opposition. Many view Wal-Mart as a bully and they do not believe that the benefits described by proponents outweigh the costs to the community. Local retailers are the number one opponents, fearing for their future in the face of super-sized competition.

Residents also fear that sprawl will accompany the introduction of a "big-box." Big-box is a term used to describe retail establishments over 100,000 square feet that are typically characterized as large concrete structures devoid of any attempt at a pleasing appearance. Sprawl is the dispersed development outside of compact urban and village centers along highways and in rural countryside. Some of the negatives are:

- the loss of open space and unique natural areas
- overdependence on the automobile and superhighways
- the impact of traffic on air quality standards
- the threat to water quality and aquifers
- the expense of costly new infrastructure
- the homogenization of rural landscapes
- the reduction of wildlife habitat
- the mismanagement of stormwater and sewage
- the deterioration of historic commercial centers (Peled, 2001)

In the past, small town shopping was centered around the downtown district, where many consumers spent time leisurely shopping and socializing. Some blame the demise of these small town activities on the discount warehouse outside of the town center, a concrete eyesore. Aesthetics are also a problem for some people. The image of a cozy, united town is contradicted by a huge concrete building without windows on a plain of seemingly endless blacktop.

The intense struggle that may manifest between those in favor and opposed to a Wal-Mart opening is documented in the film "Store Wars: When Wal-Mart comes to town" by Micha Peled. He chronicles the struggle between the Ashland, Virginia city council and residents, who formed an opposition group called the Pink Flamingos. Although the council wins in the end and Wal-Mart is allowed to open, this documentary takes a close look at the viewpoints involved in such an emotional battle. Many of the points described in this paper are expressed in the film (2001).

JOBS

The creation of jobs is often a key selling point to gain support for the introduction of a large store such as Wal-Mart. However, this is open to debate. An employer such as Wal-Mart needs a large staff to operate its facilities. One source estimates that the building of a Wal-Mart introduces 250 jobs into the local community. However, this figure is countered by opposition claims that since Wal-Mart drives other businesses out of business, the net employment effect is closer to 100 (Jacobus, 2002). A dramatic difference was noted by Shil. That survey found that only four percent of respondents saw their employment rising as the result of the new chain, while fifty-nine percent predicted serious losses in employment (1997).

The quality of the jobs created by Wal-Mart is in question as well. Wal-Mart is under scrutiny for many of its labor relations and business practices even though they were voted one of the 100 best companies to work for by

FORTUNE magazine. However that survey was by corporate executives and not the line employees themselves. Wal-Mart typically hires part-time, entry-level positions. Generally part-time positions do not qualify for benefits such as healthcare. This results in many workers working for a limited number of hours, at much lower wages, and ineligible for healthcare.

Wal-Mart is also staunchly anti-union. When a union successfully formed in the meat cutting section of one store, Wal-Mart's next move was to remove the meat packaging operations of the store. When threat of a legal battle ensued, Wal-Mart contended that that section was being phased out anyway and the persons who had formed the union were offered other, comparable jobs in the store. The butchers argued this story was merely a cover because the store had just invested in a $40,000 wrapping machine. Wal-Mart officials say that there is an open door policy in regards to the labor relations which renders unions unnecessary.

The United Food and Commercial Workers (UFCW) assert that Wal-Mart squelches employee unionization so that they may maintain control over the masses and maintain sub-par practices (Cray, 2000). Studies have shown that although workers at Wal-Mart enter their positions with pay comparable to the union wage, a significant gap begins to emerge after a period of two years. According to a survey conducted by Wal-Mart itself, employee turnover is due to lack of recognition and inadequate pay (Peled, 2001). Al Norman, a self-proclaimed "sprawl-buster" and one of the largest activists against Wal-Mart warns in an interview that, "We're putting an enormous downward pressure on the quality of jobs in this country" (Raphael, 1999). A Wal-Mart employee takes home on average less than $250 per week (Peled, 2001). The study conducted by Barnes and Connell on the introduction of Wal-Marts in the Northeast showed increased unemployment two years after the introduction of Wal-Mart. They feel Wal-Mart's propensity to hire part-time help explains the lack of positive widespread impact on the unemployment rate of the area (1996).

GIVING BACK

Many large retailers have corporate fundraising programs designed to contribute to the communities in which they are located. Wal-Mart's community involvement program is titled Good Works and has received many awards for its contributions. Wal-Mart is one of the leading supporters of education in the United States as well as the leading supporter of children's health issues. According to the Wal-Mart website, they contributed $196 million to the communities they serve through local grants and programs. Huge corporate donations are definitely a plus to hosting the retailers. These funds may be used to the benefit of the community and its inhabitants.

Even though Wal-Mart donates millions to charitable organizations, its philanthropy has still come under fire. Many report that although Wal-Mart's contributions are high in total dollar figures, their contribution as a percentage of sales is far below traditional industry standards which is estimated at around one and a half percent. Wal-Mart counters these claims with the statement that they are helping communities every day with low prices.

NEW DEVELOPMENTS

It appears that as Wal-Mart's numbers grow, so does the community competition against the store. There have been some towns that have successfully lobbied against Wal-Mart opening. But the opposition has extended beyond community organizations such as Ashland's Pink Flamingos. In some areas legislation is being drafted to prevent big-box retailers from entering. California has hosted several legislative projects. Los Angeles and San Diego have considered legislation that would limit the size of a retail establishment. There are many concerns regarding what would happen when government begins to interfere with capitalism (Desjardins, 2002).

Whether or not legislation is involved, it appears that retailers may be heeding the call of the consumer. There are currently projects being undertaken by the big-box retailers to generate a friendlier image for themselves. Wal-Mart is currently introducing Neighborhood Stores which are less than a quarter of the size of the usual superstore. Other retailers are downsizing as well. Home Depot is experimenting with smaller stores that carry much of the same items but allow easier in and out for those who do not want to fight a crowd to pick up one or two items. Part of this movement may also be due to a study which shows that more than 20 percent of respondents are shopping less at major retailers and more at smaller stores than they were four years ago (White, 2001).

The sensitivity over big business crowding in and damaging communities has become so intense that it has spawned the creation of countless websites aimed at providing information regarding businesses and their business practices. One of these sites is corpwatch.com. Other websites seem to take an almost militant approach to Wal-Mart and other organizations. Two of these are walmartsucks.org and sprawl-busters.com

Just as opposition to Wal-Mart continues to grow, so does the realm of Wal-Mart itself. Wal-Mart is continuing to make efforts to become the only retailer a consumer could need. Although courts recently put a stop to the effort of Wal-Mart to acquire a bank, they continue to propose ways in which to expand. "Some see Wal-Mart's expansion into financial services as the business equivalent of the 19th century 'manifest destiny' doctrine, and one that Wal-Mart is quite content to allow to take its course, however long that may take (Cocheo, 2003).

CONCLUSION

While there may be much hype and negative publicity circulating for Wal-Mart, they have gotten where they are today for one reason, customers like them. This can be evidenced by the overflowing parking lots 24 hours a day, seven days a week. As long as people are shopping at the stores they will continue to succeed. If they face opposition that succeeds in one town they will simply move one town over and open an establishment. The supporters from the initial proposal will follow that store and drain revenues from the first town.

Some changes for the company are anticipated. Changes such as those that have begun with the smaller Neighborhood Markets and more aesthetically pleasing exteriors may help Wal-Mart shake the bully image that it has garnered throughout the last decade. Just as small stores near a new Wal-Mart have had to adjust their marketing strategy, it is anticipated that Wal-Mart too will begin to adapt to appease the consumers. Although there appears to be growing opposition to the erection of stores, this should dissipate along with the growth rate of the stores, due to the advent of Internet shopping and trends that are hinting that consumers are not shopping at massive discounters as much as they were four years ago.

As mentioned earlier, if small stores are going to attempt to compete with Wal-Mart they will need to adjust their marketing strategy. Differentiation appears to be the most effective strategy although some have succeeded in direct competition through the development of purchasing collectives and opportunistic buying or low overhead formats. So the battle continues to rage and ultimately the question of Wal-Marts' has been left unanswered. Is Wal-Mart good for the community or detrimental? The question may fade in importance as the variety of shopping options continues to expand. However, with the remarkable empire that has been created with Wal-Mart, it is unlikely that the company will not continue to draw customers as they continue to adapt to customer wants.

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ARBITRATE, DON'T LITIGATE! AVOIDING THE HIGH COSTS OF LITIGATION

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ABSTRACT

Alternative Dispute Resolution (ADR), especially arbitration, has become an integral part of doing business as businesses consider the high costs of resolving legal disputes in court. While large corporations have embraced arbitration as a means to resolve disputes with less cost, both financial and otherwise, small business can also benefit from ADR. This paper discusses the costs of litigation and potential advantages of mediation and arbitration. The law regarding arbitration is examined to provide the business person with a working knowledge of this method of ADR. In addition, suggestions are made as to how to implement arbitration clauses into business contracts.

INTRODUCTION

Alternative Dispute Resolution (ADR) is a term most business people have heard. Most have heard of arbitration, too. For many though, these terms, and the choices they represent, may not have any practical application to their businesses, especially if the business is small. However, the advantages of ADR are available to all businesses, large and small. Arbitration, the most utilized form of ADR, has become a fixture in commercial contracts and a common method of dispute resolution for large corporations. Its application makes sense in small businesses where the costs of litigation are often not budgeted and resources can be strained by a legal dispute. For many small business owners, the concern over potential lawsuits is not acknowledged as part of doing business, but it should be.

WHY WORRY ABOUT LAWSUITS?

Picture this. You have worked hard building your business and now it looks as if that hard work is paying off. Your company has achieved some success, you have goodwill in the community, and your company's reputation is growing. You have finally reached a stage of some financial security and the reality of increased revenues. Then, you answer a knock at the door only to be handed legal service by a process server. You have been sued! Perhaps a laid off employee is claiming discrimination, or a party with whom you have contracted for services claims you did not perform as agreed. Whether a civil lawsuit is one you feel is unfounded or not, one thing is sure. Being drawn into civil litigation is costly; not just in money, but in time, unwanted publicity, aggravation and damaged business relationships. If your case can not be resolved prior to trial through some form of settlement, the next two years are going to hang over your head like a dark cloud. Win or lose, there is a high cost to civil litigation.

The fear of litigation is not ungrounded. It is a part of doing business and, for many, this fear impacts the way business is done. "In a recent Gallup survey, one out of every 5 small businesses claimed they do not hire more employees, or expand their business or introduce a new product or improve an existing product out of fear of litigation" (Davis, 2000, p. H470).

This concern is well placed. The Bureau of Justice Statistics reported that 12,000 civil cases were filed in country's 75 most populous counties in 2001 and that businesses were defendants in about half those cases (Cohen & Smith, 2004). It is an essential part of business planning to anticipate disputes, and, if possible, minimize their impact on doing business.

THE HIGH COSTS OF LITIGATION

Most think of the cost of attorneys as the highest cost of litigation and that certainly can be the case. Most often in defense work, attorneys charge by the hour. The lawyer may also maintain an hourly billing statement for legal assistants working on the case. Time sheets are kept noting the time spent on each case. The hourly rate of attorneys engaged in defense work can vary tremendously depending on geographic and population factors. The lawyer's hourly rate could be anywhere from hundreds of dollars to thousands of dollars. Over time, this is going to add up. Every phone call, every meeting, every stage of discovery, every court appearance, every hour of research is added to the time sheet. The cost of representation will be high, but there are other costs as well.

Any court action includes costs and fees in addition to the lawyer's. Court costs are assessed by the court at the close of a case. One stage of civil litigation, referred to as discovery, "probably accounts for 80 percent of all commercial litigation costs" (Saunders, 1984, p. 105). Moreover, during a trial, expert witnesses are often needed to establish trade practices or professional standards and their fees are high. Other witness fees may be assessed for those you need to testify to defend your case. Photocopying, couriers, investigators and travel costs are all potential litigation expenses.

The process of bringing a dispute to trial will also involve time. Meetings with lawyers, compiling documents, locating witnesses and the court proceedings will force a businessperson away from his or her business. Whether your business is providing services or products, the demand on your time and attention will impact your customers.

Other costs are not counted immediately in terms of dollars, although there could be such an impact on a business. The legal system thrives on openness as the means to obtain truth and that openness is illustrated by not only the public display of a trial but by the accessibility each party in a civil action has to information held by others. Records filed with court throughout a civil action, including those involved and the nature of the dispute are public record. Prior to the trial, a major stage in litigation, called discovery, requires all relevant data to be available for review by all engaged in the dispute. Information deemed confidential in your work environment will not remain so if it sheds light on the conflict between the parties or can lead to other information that will. It can be disconcerting to have your businesses financial records, tax returns, ledgers, bank statements, and cancelled checks handed over for inspection to an attorney, your opponent and other persons who can assist in the interpretation of such information. Privileged information, those forms of information not allowed to be compelled during discovery, are narrow in scope and rarely deal with financial records. Employment policies, handbooks, internal memorandums, notes, minutes from meetings can all become part of the litigation process. Once uncovered during the discovery process, confidential business information may become evidence during the trial. In this case, the information will be open to all present during the court proceeding, even the local newspaper reporter.

The publicity associated with a court case could also up the costs of litigation. While the old adage may be that bad publicity is better than no publicity, that doesn't apply well when the public impression of your business is tarnished by another's allegations that your business is not up to par. The goodwill a business has developed over time may diminish. Reputation and integrity are still qualities that will enhance a business and those can be damaged when disgruntled parties go to court.

Those disgruntled parties may also never be able to work together in the future, illustrating another high cost to adversarial litigation, the damage to business relationships (Harwell & Weinzierl, 1995). The legal system, by design, is confrontational and does not necessarily lend itself to amicable settlements if parties are unwilling. Certainly, it would seem that a less confrontational approach to a dispute could benefit all concerned and allow for continued relationships (Demery, 1996).

Moreover, it is important to consider that even while in the court system, civil lawsuits generally do settle. There is pressure from judges, attorneys, and the parties themselves to try to reach agreement and avoid the trial process. A state court survey found that only about 3% of the lawsuits brought ever reached trial (Cohen & Smith, 2004). If a lawsuit probably will not reach the trial stage, is it not more realistic to attempt to avoid the court system all together and focus immediately on attempts at the most efficient means of settlement?

THE ALTERNATIVE TO LITIGATION

Is there a way to avoid the high costs of litigation? Perhaps not always, but there are alternatives available to business owners that can serve to, if not eliminate, severely reduce the negative and costly impact of legal disputes and civil litigation. These alternatives fall under the heading of Alternative Dispute Resolution (ADR) and can be incorporated into your business plan when planning for the worst. ADR encompasses several processes that serve to move a dispute from the court system and the public sector, to a less formal and private sector. The two most utilized forms of ADR are mediation and arbitration. Both have a place in the business arena if parties to business disputes so agree.

MEDIATION

While mediation is less prevalent in the business sector, it is a form of ADR that is gaining popularity, especially when the preservation of business relationships is an objective. With this form of ADR, the disputing parties agree to meet with a neutral third party, referred to as the mediator. The mediator works to set and maintain an environment in which the each party is able to vocalize his or her position and is able to listen to the other. There can be one or multiple sessions with the mediator, depending on the willingness of the parties to continue attempts to reach agreement. With the mediator playing the role of facilitator, not decision maker, the goal is to have the parties resolve their differences themselves. If that goal can be achieved, than the agreement between the parties is reduced to writing and serves as a full settlement of the dispute. Mediation can be accessed prior to the commencement of a civil action or after.

The two essentials to mediation are that the parties must agree to a resolution of their dispute and that the mediator is not the decision maker. Should the parties not be able to resolve their differences and come to some agreement, the discussions, offers and counter-offers proposed during the mediation sessions will not be disclosed for any subsequent legal action. This enables the parties to speak freely and openly in the attempt to resolve the problem. To do otherwise would prove to have a chilling effect on the parties' willingness to talk and negotiate. Those involved in disputes may find mediation enables a mutually agreeable result that lends itself well to the continued good will of the parties (Deremy, 1996). That can be achieved because cooperation is stressed in this form of ADR (Jacobs, 1992).

Mediation also has the advantage of not imposing a decision on the parties. Unless or until the parties come to a satisfactory conclusion of their dispute, neither is under any obligation to continue the process. Mediators can meet jointly with the parties to facilitate their communications, or can serve as go-betweens and speak individually with the disputing parties. While the mediator does not resolve the dispute by making a decision, she can serve as a source of objectivity for the parties as they work through their issues (Robbins, 1997).

ARBITRATION

The much more widely used form of ADR is arbitration and it has become a significant alternative to court action. It is a fairly sure bet that a dispute resolved through arbitration will be less costly that resolution through the courts. While attorneys may play a role in the arbitration process, the amount of time spent in starting the arbitration and preparing for the arbitration hearing will be much reduced. That will reduce the costs of legal counsel. Most other court related costs, including those incurred during discovery or in obtaining expert witness, may also be dramatically reduced. Just as importantly, arbitration hearings are confidential and the disclosure of business information needed to resolve a dispute will not become part of the public record, or part of the evening's news. Not to mention the emotional relief at reaching resolution in a less costly and time consuming manner.

A LOOK AT ARBITRATION LAW

Arbitration is not a new idea but is most definitely an idea whose time has come. Amid complaints of an overloaded and ever expensive court system, more and more businesses are looking for alternatives. The Federal Arbitration Act (FAA) was enacted in the 1940's as a means for the government to support the alternative means for the resolution of disputes. It created law regarding contractual arbitration provisions that has both federal and state application (Southland Corp. v. Keating, 1984). This law does not set up the method by which arbitration is to take place, but positions the state as the enforcer of contractual agreements to access arbitration as the means to resolve differences outside of the court. While this act provides for the court review of agreements to arbitrate and limited review of arbitration awards, its true purpose was to set the stage for the support of arbitration as a public policy issue. Reducing the litigation load in the courts and supporting the freedom to contract is in the public interest and as so, will be encouraged by law.

Contractual freedom is at the heart of arbitration. In essence, the parties contract, and therefore legally agree, to refer disputes to the arbitration process than to pursue claims in court. This serves a waiver of the parties' right to sue and that, obviously, is a serious right to give up. Therefore, the court is still involved to the extent that contractual provisions pertaining to arbitration can be reviewed by a court in order to determine whether the contract establishing the arbitration requirement meets the requirements of law. Issues of legal capacity and the mutual assent of the parties can be in dispute and, if not satisfied in law, the enforceability of the agreement to arbitrate is put in dispute.

The resolution of a disagreement as to the validity of a contract is generally determined by state law and as such, can vary in state jurisdictions. However, the Federal Arbitration Act preempts all state law that would serve to restrict the enforcement of arbitration clauses (R.J. Palmer Construction Company v. Witichta Band Instrument Co., 1982). As long as the contract containing the clause is enforceable, the arbitration requirement will be too. The FAA is applicable to the arbitration provisions only (Rickard v. Teynor's Homes Inc., 2003) and only when those provisions are in contracts engaged in interstate commerce (Shearson Hayden Stone, Inc. v. Liang, 1980). Otherwise, federal jurisdiction is limited to controversies involving federal law or involving diversity of citizen and high dollar amounts. The FAA does not confer federal court jurisdiction over disputes involving contractual provisions regarding arbitration but does allow those provisions to be enforced by state courts using the federal law (R.J. Palmer Construction Company v. Witichta Band Instrument Co., 1982).

One of the common disputes regarding arbitration provisions involves a determination as to whether the parties had fully agreed and freely entered into the contract. However, contract law is strict in enforcing contracts where the parties knew the nature of the agreement and acted with free will. Again, it is in the public interest to promote arbitration and contracts utilizing that process. Federal courts have set the policy that private arbitration agreements should be "rigorously" enforced (Peoples Sec. Life Ins. Co.v. Monumental Life Insurance Co., 1989, p. 812).

If the underlying contract containing the arbitration provisions is valid and enforceable, then the courts will compel the parties to arbitrate. Any court proceeding of a similar nature to the issues included in the agreement to arbitrate will be put on hold, or stayed, until the arbitration takes place (9 U.S.C.S. § 3 (1947)). However, the party seeking arbitration must more quickly. Unreasonable delay in seeking arbitration at this point could lead to a court decision that the party waived the right to arbitrate (Secrist v. Burns International Sec. Servs., 1997). Moreover, under the FAA a court is authorized to order parties to arbitration should one party to the dispute refuse to proceed to arbitration (Townsend v. Smith Barney Shearson, 1995). The court may even appoint an arbitrator if need be (9 U.S.C.S. § 5 (1947)).

The courts play a limited role after an arbitration award has been made since to provide otherwise would "frustrate basic purposes of arbitration" (Federal Commerce and Navigation Co. v. Kanematsu Gosho, Ltd., 1972).There are exceptions. First, either party may apply to the court to confirm the award and have the award entered as a judgment. This will require that the confirmation by court was part of the original contractual agreement of the parties. Moreover, the court may review and even modify an arbitration award should the final award have numeric miscalculations and "evident and material mistakes as to a person, thing or property referenced in the award" (U.S.C.C. 9 § 11(a) (1947)) or if the arbitrator has made a determination to a matter not submitted to arbitration (9 U.S.C.S. § 11(b) (1947)). Finally, the court can actually vacate an arbitration award under very restrictive circumstances. The Federal Arbitration Act specifically provides for vacating awards "procured by corruption, fraud or undue means," (9 U.S.C.S. §

10(a)(1) (1947)) situations where the arbitration's actions meet a standard of "misconduct," (9 U.S.C.S. § 10(a)(3) (2002)) or where arbitrators "exceed their powers" ((9 U.S.C.S. § 10(a)(4) (1947)).

Arbitrators, however, have considerable leeway in conducting hearings and reaching awards. The FAA does give an arbitrator some authority to summons witnesses and relevant documents in order to allow for the presentation of evidence at the arbitration hearing (9 U.S.C.S. § 7 (1947)). However, once the award is reached, the arbitrator is not required to enumerate her reasons for her decision and award (Sperry International Trade, Inc.v. Government of Israel, 1985). Legally, the arbitrator is required to give only a "fundamentally fair" hearing (Bell Aerospace Co. Div.of Textron, Inc. v. International Union, United Auto, etc., 1974).

The court has no power to vacate an award even in situations where the arbitrator misunderstood the law (Denver and Rio Grande W.R.R. v. Union Pac. R.R., 1997). For the court to intervene, the arbitrator has to engage in a "manifest disregard" for the law. An award must demonstrate an understanding of the law which is then intentionally disregarded to earn vacating by the court (Reynolds Secur., Inc.v. Macquown, 1978). Refusing to hold a hearing or to allow parties to submit evidence illustrates arbitrator misconduct that leads to the vacating of an award. (Riko Enterprises, Inc. v. Seattle Supersonics, Corp., 1973). This authority extends to state courts, which, under the FAA, also have the jurisdiction to review and, if justified, vacate awards (National Railroad Passenger Corp. v. Blanchette, 1977).

However, the message is clear that courts will not become involved in review of arbitration hearings and awards except in the most extreme cases. While contracts are the essence of arbitration, the review of arbitration awards by the courts can not be expanded even should the parties agree to it (Koycera Corp. v. Prudential-Bache T Servs, 2003).

IMPLEMENTING ARBITRATION

To utilize arbitration to its fullest, parties can agree on the dynamics of the arbitration hearing. This would include the selection of the arbitrator or arbitrators, time frames and the information that both parties will have access to from the other. Since arbitration is based on contract, the abilities of the parties to agree on such elements are crucial. Selection of an arbitrator is of significance in that someone with expertise in the field, credentials and experience is much more likely to make appropriate awards. Arbitrators may be lawyers or retired judges, but can be experts in any profession (Hall, 2001). Many concerns of an arbitrator's bad faith can be eliminated to a great extent, by selection of an appropriate arbitrator.

There are, of course, disadvantages to arbitration. The reduced access to the court could work against a party rather than in his or her favor. A poor award by the arbitrator can not be reviewed. Moreover, the arbitration process does not provide as extensive information gathering and investigation as the discovery stage within a civil lawsuit allows. However, civil litigation does not provide guarantees of success or satisfaction either and often winning a lawsuit is tainted by the costs and stress caused by the process. The thoughtful implementation of arbitration to resolve disputes remains a variable alternative.

Practical issues such as how to include arbitration clauses in contracts, how to find an arbitrator or how to schedule the hearing can impair access to arbitration. Many of those issues can be resolved by careful drafting of arbitration clauses in contracts. These clauses can be specific and outline the arbitration process including selection of arbitrators, access to information and the manner in which the arbitration hearing will be conducted. A simple contractual phrase stating disputes will be resolved by arbitration will suffice, but fails to identify all the issues involved in the process. The only requirement in law is that the agreement to arbitrate must be in writing (Ward Foods, Inc. v. Bakery & Confectionery Workers Union, 1973).

While parties can decide on many of these issues, organizations are available to provide assistance as those in conflict move toward alternatives to litigation. The American Arbitration Association (AAA) and JAMS are perhaps the most widely recognized nonprofit organizations providing services to those seeking to utilize all forms of ADR including arbitration. The AAA "is dedicated to the development and widespread use of prompt, effective and economical methods of dispute resolution" (American Arbitration Association, About Us). JAMS also provides assistance for those seeking mediation or arbitration and has, as its available arbitrators, retired judges and lawyers. (JAMS, Welcome).

Nonprofit organizations can assist in a wide variety of ways, from selecting an arbitrator to selecting a location for the arbitration hearing. Rules for arbitration, guides for arbitrator's, listings of arbitrator's and their credentials, forms needed to commence and conduct the arbitration hearing have been developed by these organizations. Moreover, the organizations have developed a variety of contractual provisions for inclusion in business contracts. The standard AAA contract provision provides that

> Any controversy or claim arising out of or relating to this contract, or the breach thereof, shall be settled by arbitration administered by the American Arbitration Association in accordance with its Commercial [or other] Arbitration Rules [including the Optional Rules for Emergency Measures of Protection], and judgment on the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof (**Drafting Dispute Resolution Clauses-A Practical Guide).**

> JAMS also provides sample clauses, including

> Any dispute, claim or controversy arising out of or relating to this Agreement or the breach, termination, enforcement, interpretation or validity thereof, including the determination of the scope or applicability of this agreement to arbitrate, shall be determined by arbitration in (insert the desired place of arbitration), before (one) (three) arbitrator(s). The arbitration shall be administered by JAMS pursuant to its Comprehensive Arbitration Rules and Procedures (Streamlined Arbitration Rules and Procedures). Judgment on the Award may be entered in any court having jurisdiction. This clause shall not preclude parties from seeking provisional remedies in aid of arbitration from a court of appropriate jurisdiction. (Optional) Allocation of Fees and Costs: The arbitrator may, in the Award, allocate all or part of the costs of the arbitration, including the fees of the arbitrator and the reasonable attorneys' fees of the prevailing party (JAMS Guide to Dispute Resolution Clauses for Commercial Contracts).

This is just one of several provisions the AAA and JAMS include at their web sites and those sites are excellent resource for the business person. Certainly, an attorney can prepare such contractual provisions. The legal consequences of including such provisions in business contracts should be discussed with an attorney.

NOTE REGARDING EMPLOYMENT CONTRACTS

While the inclusion of arbitration clauses in a wide variety contracts have been upheld in the courts, one area of particular concern is the inclusion of these provisions in employment contracts. Settling employee disputes by means of arbitration rather than litigation can prove especially beneficial to business and the courts have repeated supported the use of arbitration in this area.

In the case of Circuit City Stores v. Saint Claire Adams (2001), the U.S. Supreme Court ruled that the Federal Arbitration Act's application to employment contracts extended to state laws designed to prohibit employment discrimination. This case presented questions as to the interpretation of the statute and the Court determined that all employment contracts, except those of transportation workers, were covered by the FAA. This means that arbitration clauses can be part of employment contracts and that employees with legal claims against employers will be required to arbitrate their disputes even when the employee's claim stems from state law rather than federal law. Prior to this case, employment disputes involving federal law and involving agreements to arbitrate had been consistently upheld by the courts, including claims of age discrimination (Gilmer v. Interstate/Johnson Lane Corp., 1990) and sexual harassment (Maye v. Smith Barney Inc, 1995).

However, the agreement to arbitrate in employment contracts will not stand if the courts determine that the means by which the resolution process takes place is not fair. In Hooters of America, Inc., v. Phillips (1999), the court found the resolution process too biased toward the employer and in Ting v. AT&T (2002), an agreement to arbitrate was struck down because, as one reason, it severely limited the remedies to which the employee would be entitled. Particular care must be given to drafting arbitration clauses in employment contracts and in determining the method by which the employment disputes will be resolved.

CONCLUSION

Businesses large and small can turn to alternative dispute resolution processes in many commercial, consumer and employment contracts. Courts have consistently enforced fair agreements and have expressed continued support for alternative means to resolve legal disputes. It is an important part of the business plan, even for small business, to consider the consequences of a legal dispute and to consider the most efficient and effective way to handle such issues. ADR is not just for large corporations, it can also well serve the small business providing significant advantages to civil litigation. Planning, seeking appropriate legal advice, and appropriate contract drafting can help a small business create an environment for dispute resolution that bypasses the courts. Decreasing the costs of litigation, from attorney's fees to damaged business relationships, should be an important consideration in all business plans.

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WHO ARE THE SELF-EMPLOYED?

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ABSTRACT

The purpose of this paper is to describe the self-employed in the United States (as identified by the 2000 U. S Census) and show how they differ from employees who are not self-employed. The findings suggest that the self-employed are generally older, more likely to be male, and in more lasting marital relationships than employees in governments and private companies. The self-employed are predominately White and generally make more money than those workers who are not self-employed.

INTRODUCTION

During most of the 20th Century, the United States has utilized neoclassical economic theory to guide the economic development efforts of the nation. One of the central concepts of neoclassical economic theory is economies of scale, which assumes that as the size of the firm increases, the per-unit cost of the product decreases. America's adoption of neoclassical economic theory and the domination of large firms have led many Americans to believe that large firms are the key source of creation and distribution of wealth. Two influential books supported the importance that large businesses play in economic development. William Whyte's (1956) book, *The Organization Man*, suggested that the Great Depression and military training in World War II created a society willing to accept employment in, and obedience to, large bureaucracies. John Kenneth Galbraith (1967) in his book *The New Industrial State*, suggested that those large corporations, working in coordination with governments and labor unions, would run nations in the future. Neoclassical economic theory, which has been the mainstream economic theory in the United States for a century, supported the concept that big business is a very important part of economic development.

Other economists have argued that the entrepreneur is an integral part of the economic development process. Schumpeter (1934) saw innovation as the key for creating new demand for goods and services and entrepreneurs, as owner-managers, were the driving forces who start businesses to exploit innovation. Schumpeter's supposition that entrepreneurship made a significant contribution to economic development has been supported by numerous studies. In a study of U. S. firms during the period from 1969 through 1976, Birch (1987) discovered that small firms (firms with 100 or fewer employees) created 81 percent of the net new jobs in the United States. Birch also reported that an analysis of the U. S. Small Business Administration data base from 1969 through 1990 indicates those firms with 100 or fewer employees are the primary job creators in the United States. Entrepreneurs in the United States start between 3.5 million and 4.5 million businesses each year. (NFIB, 2000, p. 15) And the small business economic sector in the United States is the world's largest economy, trailing only the overall economy of the United States and the economy of Japan. (NFIB, 2000, p. 33) It is becoming increasingly evident that small firms, in the current environment of rapid change and high technology, are a driving force in the U. S. economy. Scarborough and Zimmer (2003, pp. 2-3) suggest that whereas twenty-five years ago competitive advantages favored large companies, today the balance has tipped in favor of small, entrepreneurial companies. The entrepreneurial economy is growing. The U. S. Government reports that almost 10% of the people in the 2000 Census classified themselves as self-employed.

We know a lot about why people go into business for themselves. Research has shown that the six most frequently given reasons for becoming self-employed are for the opportunity (1) to gain control over their own destiny, (2) to make a difference, (3) to reach their full potential, (4) to reap unlimited profits, (5) to contribute to society, and (6) to do what they enjoy doing. (Scarborough & Zimmer, 2003, pp. 9-11) Although we may know a lot about why people give up the security of regular employment for self-employment, we do not know much about whom these people are and how they differ from those who are not self-employed. Who are these people who give up the security of employment with private firms or government agencies to open their own businesses and assume the risks of failure for the possibility of future profits?

PURPOSE OF STUDY

The purpose of this study is to describe the self-employed in the United States (as identified by the 2000 U. S Census) and show how the self-employed differ from those who are employed by local, state and federal governments and by private for-profit and not-for-profit companies.

SAMPLE

The 2000 U.S. Census 5% Public Use Microdata Sample was used as the data source for this study. Analysis was restricted to individuals who listed themselves as either self-employed in incorporated or unincorporated businesses, employed in local, state, or federal governments, or employed in private for-profit or private not-for-profit companies. Persons less than 16 years of age, persons who were unemployed with no work experience in the last five years, and persons who listed themselves as unpaid family workers were excluded from the study.

In attempting to describe the self-employed and show how they differ from those who are employed by private companies or by governments, a comprehensive list of demographic characteristics would be useful. We are, however, limited to describing individuals by the demographic characteristics identified by the U. S. Census. For example, although it may be fruitful to ascertain if religion or political preference plays a role in a person's selection of employment, the U. S. Census does not provide this information in the 5% Public Use Microdata Sample. So, when using the U. S. Census as the data base, we must be content with describing individuals by the demographic characteristics provided by the government. For the purposes of this study, we have chosen the following demographic characteristic from the U. S. Census; sex, age, race, marital status, education, citizenship, place of birth, English ability, and total earnings.

For the purpose of identifying a person's race, minority group members have been classified into five categories:

African American (except Hispanic)..	A person having origins in any of the black racial groups of Africa
American Indian or Alaskan Native (Native).	A person having origins in any of the original peoples of North America and who maintain their culture through a tribe or community.
Asian or Pacific Islander (Asian).	A person having origins in any of the original people of the Far East Southeast Asia, India, or Pacific Islands.

Hispanic.	A person of Mexican Puerto Rican Cuban, Central or South American or other Spanish culture or origin, regardless of race.
Other Minority. .	A person who entered two or more major race groups or wrote in an entry such as multiracial or mixed in the census report

With the exception of the Other Minority category, this classification system follows the EEOC guidelines that specify that the term minority is used to mean four particular groups who share a race, color or national origin. (EEOC, 2003)

The 2000 U.S. Census 5% Public Use Microdata Sample of employed persons consisted of 8,259,041 people of which almost 10% were self-employed. The sample consisted of 52% males, of which 58% were currently married; 87% were born in the USA, and 93% were US citizens. Racial distribution of the sample was 73% White. Less than 4% of the sample rated their English ability as not well or not at all.

The sample was well distributed across age groups with 38% of the sample less than 35 years of age, 45% were between 35 and 54 years of age, and 17% were 55 years or older. Almost one-half of the sample (46%) had a high school education or less; 31% had some college but no bachelor's degree, and 23% had a bachelor's degree or better. More than 85% of the sample earned less than $50,000 annually. Of the remaining 15% of the sample, 9% earned from $50,000 to $74,999 annually, and only 6% earned $75,000 or more. Remember that this sample does not reflect the overall population of the United States, but is a fairly accurate reflection of those who are employed.

FINDINGS

Impact of Gender and Marital Status.

As can be seen in Table 1, the self-employed are quite different in terms of gender and marital status than employees of governments and private companies. A much larger percent of the self-employed are male and married than those who are not self-employed. More than 65% of the self-employed are male, whereas only about 50% of employees of governments and private companies are male. Almost

72% of the self-employed are currently married, whereas only about 56% of employees of governments and private companies are currently married.

Table 1: Percent Distribution of Self-Employed Persons and Employees Who Are Not Self-Employed by Gender and Marital Status, 2000		
Gender	Self-Employed	Employees Not Self-Employed*
Male	65.3%	50.4%
Female	34.7	49.6
Martial Status		
Married	71.9%	56.3%
Not Married	28.1	43.7
* Consists of employees of local, state, and federal governments and employees of private for-profit and not-for-profit companies.		
Source: 2000 U.S. Census 5% Public Use Microdata Sample		

Impact of Foreign Birth.

Table 2 shows the percent distribution of self-employed and employees who are not self-employed by place of birth, citizenship, and English-speaking ability. As can be seen in Table 2, none of these demographic characteristics had much of an impact on a persons choice of career. Approximately 87% of both the self-employed and the employees of governments and private companies were born in the USA; 94% of the self-employed and nearly 93% of the employees of governments and private companies were citizens of the USA; and about 3% of the self-employed and almost 4% of the employees of governments and private companies considered their English-speaking ability as “not well” or “not at all.”

Table 2: Percent Distribution of Self-Employed Persons and Employees Who Are Not Self-Employed by Place of Birth, USA Citizenship, and English Speaking Ability, 2000

	Self-Employed	Employees Not Self-Employed*
Place of Birth		
Born in USA	87.0%	86.6%
Not Born in USA	13.0	13.4
Citizenship		
Citizen of USA	94.1%	92.8%
Not Citizen of USA	5.9	7.2
English Speaking Ability		
English Only	84.9%	83.1%
Very Well	8.0	9.4
Well	3.8	3.6
Not Well	2.5	2.7
Not at All	0.8	1.2

* Consists of employees of local, state, and federal governments and employees of private for-profit and not-for-profit companies.

Source: 2000 U.S. Census 5% Public Use Microdata Sample

Minority Status

As can be seen in Table 3, meaningful differences can be seen between the self-employed and employees who are not self-employed with respect to minority group representation. A much smaller percentage of African Americans and Hispanics are self-employed than are employed by governments and private companies. The percentage distribution of Asians, Natives, and Others appear to be similarly divided between being self-employment and employment by others. Non-minority persons dominate the self-employed with almost 83% of the self-employed being White while only about 72% of those working for governments and private companies are White.

Table 3: Percent Distribution of Self-Employed Persons and Employees Who Are Not Self-Employed by Minority Status, 2000		
	Self-Employed	Employees Not Self-Employed*
African American	4.6%	10.6%
Asian	3.4	3.5
Hispanic	7.3	11.1
Natives	0.6	0.8
Others	1.4	1.6
White	82.7	72.3
* Consists of employees of local, state, and federal governments and employees of private for-profit and not-for-profit companies.		
Source: 2000 U.S. Census 5% Public Use Microdata Sample		

Age and Education

Table 4 shows the percentage distribution of self-employed and employees who are not self-employed by age and education. Age appears to be a big factor in whether some persons choose self-employment. Governments and private companies appear to have a larger percentage of their workforce as young employees as compared to the self-employed. Only about 18% of the self-employed are less than 35 years of age while nearly 40% of employees of governments and private companies are less than 35 years of age. Middle-aged persons (i.e., employees aged 35 through 54) represent a little over 52% of the self employed but only about 44% of those not self-employed. A meaningful difference between the self-employed and those not self-employed can be discerned in the age group of employees aged 55 and older. Whereas almost 30% of the self-employed are 55 years and older, only about 16% of those employed by governments and private companies are in this age group. Interestingly, education does not appear to be a meaningful factor in self-employment. In almost every educational group, 2.5 percentage points or less separate the distribution between the self-employed and those who are not self-employed. Only in the highest educational level (i.e., Professional/PhD) does education have a meaningfully larger percentage of self-employed persons (i.e., about 7%) than those not self-employed (just over 2%).

Table 4: Percent Distribution of Self-Employed Persons and Employee Who Are Not Self-Employed by Age and Education, 2000		
	Self-Employed	Employees Not Self-Employed*
Age		
16-24	4.2%	17.8%
25-34	13.7	22.1
35-44	26.1	24.4
45-54	26.0	19.8
55-64	17.5	10.9
65 +	12.5	5.0
Education		
No High School	16.0%	18.1%
High School	27.7	28.3
Some College	28.3	30.8
Bachelors Degree	16.1	15.0
Masters Degree	5.1	5.6
Professional/PhD	6.9	2.3
* Consists of employees of local, state, and federal governments and employees of private for-profit and not-for-profit companies.		
Source: 2000 U.S. Census 5% Public Use Microdata Sample		

Annual Earnings

As can be seen in Table 5, self-employment has an impact on total annual earnings of individuals. Whereas almost 86% of those employees working for governments and private companies earn less than $50,000 annually, only 78% of the self-employed earn less than $50,000 annually. The distribution of total annual earnings in the $50,000 to $74,999 categories is about 9% for both the self-employed and those who are not self-employed. The biggest difference between the two groups comes in the total annual earnings categories of $75,000 annually or over. In every category of $75,000 or over, the percentage of self-employed exceeds the percentage of those who are not self-employed. Overall, almost 13% of the self-employed earn $75,000 or more in comparison with only about 5% of employees of governments and private companies.

Table 5: Percent Distribution of Self-Employed, Government Employed, and Privately Employed Persons by Total Annual Earnings, 2000

	Self-Employed	Employees Not Self-Employed*
Under $25,000	57.1%	57.5%
$25,000 - $49,999	20.9	28.3
$50,000 - $74,999	9.2	9.0
$75,000 - $99,999	4.1	2.7
$100,000 - $149,999	3.7	1.5
$150,000 - $199,00	0.8	0.3
$200,000 and over	4.3	0.7

* Consists of employees of local, state, and federal governments and employees of private for-profit and not-for-profit companies.

Source: 2000 U.S. Census 5% Public Use Microdata Sample

CONCLUSIONS

It appears that the self-employed are similar to employees of governments and private companies in some ways and quite different in others. The self-employed are more likely to be male and currently married. This fact belies current arguments that self-employment is extremely tough on family relationships. On the other hand, it may be that having a working spouse allows the freedom to take the risks involved in entrepreneurial activities. Foreign birth appeared to have no meaningful impact on a person's choice of employment. Although it is popular to assume that entrepreneurship is a haven for immigrants hindered with poor English-speaking ability, this has proven to be untrue. No meaningful differences could be found between the self-employed and employees who were not self-employed when analyzed by place of birth, USA citizenship, or English-speaking ability.

Minorities continued to be a "minority group" among the self-employed with only 17% of the self-employed being minority persons, whereas minorities make up 27% of the non self-employed workers. Age is also a dominant factor in self-employment with almost 30% of the self-employed being over the age of 55 in contrast to only 16% of those not self-employed. Education, however, does not appear to be a meaningful factor in being self-employed except in the highest education level, i.e., Professional/PhD. This can be easily explained by the requirement for advanced degrees in many of the professions, such as law and medicine, that select self-employment as their primary choice of business organization. Considering the fact that almost 78% of the self-employed earn less than $50,000 annually while more than 85% of the non-self-employed workers earn less than $50,000 and almost 13% of the self-employed earn $75,000 or over and only about 5% of those who are not self-employed earned $75,000 or over, it appears that more opportunities exist for earning a higher income if one is self-employed.

In summary, the self-employed appear to be older, more male and in more lasting marital relationships than their counterparts in governments and business. Place of birth, citizenship, and ability to speak English do not differentiate the self-employed from other workers, although minority status does. The self-employed appear to be mostly White. Education only impacts the choice of self-employment versus working for others at the professional and PhD level. And lastly, the self-employed appear to have higher annual earnings than those who work for governments and private companies.

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BEYOND HUMAN AND SOCIAL CAPITAL: THE IMPORTANCE OF POSITIVE PSYCHOLOGICAL CAPITAL FOR ENTREPRENEURIAL SUCCESS

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ABSTRACT

Financial, human, and social types of capital are widely discussed in the literature as they relate to entrepreneurial success. To date, however, positive psychological capital has not received adequate attention by academics or practitioners. Psychological capital refers to psychological states such as hope, confidence, resilience, and optimism, which are discussed in this paper as being crucial for entrepreneurs to genuinely demonstrate. The four states are discussed and the Expanding Capital Model for Entrepreneurial Success is introduced.

INTRODUCTION

The word capital refers to the value of assets and resources available for a specific need. Many times financial capital comes to mind when thinking about an entrepreneurial venture, whether it is fixed, working, or growth capital. However, other types of capital are just as important to consider. These include human, social, and most recently psychological capital, which all incorporate the intangible assets and resources supplied by people involved in an entrepreneurial venture, most importantly the top management team. The more widely discussed human and social types of capital are reviewed, however, the primary focus of this paper is on psychological capital.

The author contends that positive psychological capital demonstrated by an entrepreneur or top management team of an entrepreneurial venture is crucial for short and long-term success. Further, while financial, human, and social capital can vary in degrees among top management, all members must demonstrate high levels of positive psychological capital to ensure entrepreneurial success.

HUMAN CAPITAL

Human capital, often referred to as intellectual capital, is the value of the skills, abilities, knowledge, and experience a person brings to an organization. Stewert (1999) defines intellectual capital as 'organized knowledge that can be used to produce wealth,' and contends that it is the most important resource in today's organizations, which must operate in the Information Age where knowledge is the preeminent resource.

When considering who to bring to the top management team of an entrepreneurial venture, potential candidates are often evaluated on things such as previous entrepreneurial experience, knowledge of the industry and market, years of education, past work experience, and technical knowledge directly related to a product, service, or process. These factors are important in today's volatile business environment, especially in small, entrepreneurial companies that must continually be flexible, innovative, and quick to react to market demands. Dakhli and De Clercq (2004) empirically tested the relationship between human capital and innovation across 59 different countries. Their findings reveal that there is a positive relationship. Likewise, Hayton (2004) studied 99 small to medium sized enterprises and found a positive relationship between human capital and entrepreneurial performance. It also appears that venture capitalists may even overemphasize human capital when making their investment decisions (Baum & Silverman, 2004).

Laferrere (2001) separated formal versus informal human capital within entrepreneurial businesses, with formal human capital referring to educational qualifications while informal human capital was knowledge and skills acquired by having parents who were entrepreneurs. It was discovered that individuals who grew up in families where one or both parents owned a business were able to attain "inside" knowledge of enterprise. Likewise, Anderson and Miller (2003) explored how entrepreneurial family background impacts the development of human capital. Those with high socioeconomic groupings were highly endowed with human capital, which ultimately led to greater profitability and growth potential. Therefore, evaluating the level of human capital one brings to the top management team of an organization is very important to consider. Often, the degree of human capital sought is directly related to the specific needs of the business in regard to the environment in which it operates. It is important to note, however, that this paper is not suggesting that higher socioeconomic groupings with higher levels of human capital are those people who traditionally become entrepreneurs. In fact, those with fewer means may be more likely to take the risks associated with entrepreneurial ventures.

SOCIAL CAPITAL

Social capital refers to the value of actual or potential assets and resources a person can acquire for an organization based on who he or she knows, what networks that person is associated with, as well as his or her reputation in certain communities. Trust between members of a social network, as a necessary condition for innovation and economic development, is central to the concept of social capital (Lorenz, 1992; Storper, 1993; Putnam, 1995).

When considering who to bring to the top management team of an entrepreneurial venture, potential candidates are often evaluated on things such as their reputation in the business community, what associations they belong to, and people they know who can provide financial assets, information, or other resources to the organization. Empirical research shows that social capital translates directly into financial assets (Belliveau, O'Reilly, & Wade, 1996), as entrepreneurs with higher levels of social capital are more likely to receive funds from venture capitalists than entrepreneurs with lower levels (Shane & Cable, 1999)

In a sense, social capital provides individuals with an important credential that can be directly converted into tangible assets (Baron & Markman, 2000). The basic idea is that norms of reciprocity, obligation, and trust are established within social networks (Coleman, 1988; Portes, 1995). Social capital does not constitute the resources or assets themselves, but rather the ability of the individual to attain and mobilize them (Portes, 1995). It can be likened to the exchange theories in leadership where group members make contributions at a cost to themselves and receive benefits at a cost to the group or other members. Interaction continues because members find social exchange mutually rewarding (Bass, 1990).

Reimer (2004) contends that if one prepares a business plan with others, social capital is being built, and with each successful transaction, that social capital is being reinforced and used for productive ends. Social capital in the marketplace can even be thought of as stock in some cases (Policy Research Initiative, 2003).

Like human capital, it is very important to assess how much social capital one could bring to the entrepreneurial venture if chosen to be a member of the top management team.

PSYCHOLOGICAL CAPITAL

While human capital refers to "what you know" and social capital refers to "who you know", psychological capital is reflected in person's self-view or sense of self-esteem (Goldsmith, Veum, & Darity, 1997). Thus, one could look at psychological capital as a person's sense or view of his or her ability to successfully utilize the financial, human and/or social capital he or she brings to an organization in a productive manner.

Psychological capital encompasses an array of personal characteristics, which can influence productivity. For example, Goldsmith, Veum and Darity (1997) used Rosenberg's (1965) Self-Esteem Scale to operationalize psychological capital as it relates to wage rates of lower-level employees (those who had finished high school and were employed). Their findings indicate that self-esteem, as a broad measure of psychological capital, is positively and significantly related to wages earned. Self-esteem can also be related to productivity as Schultz (1994) demonstrates. He contends that self-esteem is essential to the success of any organization and illustrates that people who develop healthier concepts of themselves enhance their own productivity and thus the success of the organization.

The author of this paper chose to use the four constructs of *hope*, *confidence*, *resilience*, and *optimism* to embody the concept of psychological capital for an entrepreneur. These constructs were chosen because: (1) Self-esteem appears to be too general and basic to capture how an entrepreneur or someone in a top management position would view him or herself; and (2) These four constructs were recently used by Luthans, Luthans, and Luthans (2004) to demonstrate the importance of positive psychological capital in the business environment.

It is important to note that these four constructs are not psychological traits, but psychological states. Generally, a trait is something a person either has or does not have. A state involves behaviors, thoughts, and actions that can be learned and developed in almost anyone. It is also imperative to understand that in order for an individual to genuinely exhibit these four states, he or she must firmly accept the reality within an identified situation.

Hope

Hope is a desire accompanied by an expectation of fulfillment. It is a positive motivational state with two important components, (1) the physical and mental energy to meet goals, or "willpower" and (2) having identified avenues to meet those goals, or "waypower"(modified from Snyder 2000, and Luthans et al., 2004).

Hope becomes an enduring psychological state when a person attributes permanent and universal causes to good events along with temporary and specific causes to bad events (Seligman, 2002). An example of a bad event for an entrepreneur is losing an important customer. Consider two responses to the loss: "I'm miserable at business," versus "I really need to learn more about good customer relations." The second statement is much more hopeful in nature as it is specific to customers, and it is temporary with the assumption that with more knowledge gained, customer relations will improve. The first statement is universal and thus implies a sense of hopelessness. Hope has been shown to have a positive effect on leadership and workplace performance (Peterson and Luthans, 2003).

As an entrepreneur, one would be more successful if he or she has the energy to strive for the business' goals (willpower) as well as the ability to identify the avenues for reaching them (waypower). A loss of hope, either in a decrease in willpower or waypower, would have a negative effect on the entire business. And thus, one may even lose a significant amount of human or social capital because he or she has lost hope in his or her abilities or in the entire business.

Confidence

Confidence is defined as a person's conviction about his or her abilities to successfully execute a given task within an identified context (modified from Luthans, et al., 2004). Stajkovic and Luthans (1998) have empirically shown that confidence has a positive effect on work performance, and Stajkovic (2003) has used this psychological state to develop his core confidence factor of work motivation.

Famed cyclist Lance Armstrong said, "The world is full of people who are trying to purchase self confidence, manufacture it, or simply posture it. But you can't fake confidence, you have to earn it, and they only way to do that is work" (Armstrong, 2003). In other words, a person cannot truly gain conviction about his or her abilities to execute a given task unless he or she works to become better at that task. The person with the most expensive set of golf clubs on the course is oftentimes not the best golfer. Likewise, an entrepreneur can only gain confidence in his or her ability to attract investors and secure capital if hard work is involved.

An entrepreneur should feel confident in the knowledge, skills, and capabilities he or she brings to the business backed by a good work ethic. The demonstration of this confidence should be genuine and only attained through hard work. The business would surely suffer and possibly never get off the ground if the entrepreneur was simply posturing confidence, and truly lacked the human and social capital he or she purportedly possessed.

Resilience

Resilience is the process of adapting well in the face of adversity, trauma, tragedy, threats, or even significant sources of stress, such as business failure (modified from Luthans, et al., 2004). Research has shown that resilience is ordinary, not extraordinary (Road to Resilience, 2004). People commonly demonstrate resilience. One example is the response of many Americans to the September 11, 2001 terrorist attacks and individuals' efforts to rebuild their lives. According to Coutu (2002), resilient people unfalteringly accept reality, have an extraordinary ability to adapt to significant change, and deeply believe that life is meaningful.

Based on a survey by Timmons (1999), resilience was found to be a common trait that all successful entrepreneurs share. He states that entrepreneurs respond to change and learn from their mistakes. They do not blame others for their mistakes, but rather use failure as a lesson. Likewise, psychologist Kosmas Smyrnios found resilience to be a shared trait among entrepreneurs and showed that the personality traits of entrepreneurs are an important driving force of the businesses (Gome, 2003).

Because of the common setbacks associated with entrepreneurial ventures when compared to existing organizations, it is easy to see why an entrepreneur must demonstrate this positive psychological state even more so than a general manager.

Any business would surely suffer if the entrepreneur (leader of the venture) were not able to bounce back from adversities. He or she must also be able to accept the reality of a given situation and adapt.

Optimism

Optimism is defined as the positive side of an emotion that is utilized to explain good and bad events (Seligman, 1998). This explanatory style has two important dimensions, permanence and pervasiveness. Permanence is in regard to time. When a bad event occurs, the optimist will see it only as a temporary situation, whereas a pessimist will view it as permanent. For example, assume an entrepreneur lost a key employee. Now consider the following two statements: “We need to find out why she left so we can prevent other employees from leaving,” versus “We’ll never be able to keep good employees.” The first statement is temporary in nature, while the second statement is permanent, as the first one incorporates a sense that things can improve.

Pervasiveness is about space. People who make specific explanations about bad events are optimistic, while people who make universal explanations about bad events are pessimistic. Consider again the lost employee and compare these two statements: “Losing her will really hurt our production department for awhile,” versus “We might as well sit back and wait for everyone else to quit too.” The first statement is solely about the immediate impact of losing that one key employee and focuses on a specific part of the business, while the second statement is universal in nature and assumes the worst-case scenario for the entire business.

Optimism is a very important characteristic for an entrepreneur to possess. Jeff Bezos, the founder of Amazon.com stated, “I believe that optimism is an essential quality for doing anything hard – entrepreneurial endeavors or anything else” (Walker, 2004).

CONCLUSION

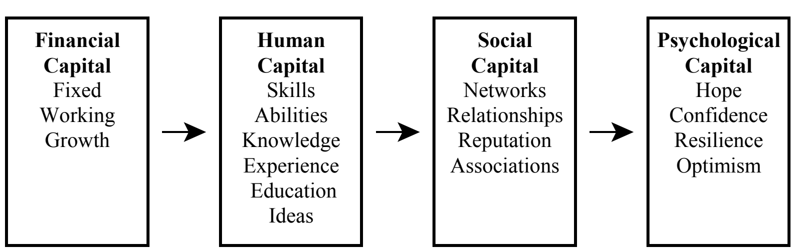
The importance of psychological capital becomes clear when one considers all that an entrepreneur or entrepreneurial team must overcome in order to achieve success. These events can come in a variety of forms including lack of funding, legal constraints, a weakened economy, an increase in industry standards, employee turnover, a deluge of new competitors, changing customer needs, among other events and situations. These types of trials can lead an entrepreneur to alter the original business plan, eliminate segments of the business, revise timelines and goals, change the entire direction of the company, and can even lead to business failure. It is also important to note that these trials are much more pronounced for the entrepreneur than for long existing organizations and general management in larger organizations. This is why positive psychological capital may be even more essential to establish and maintain in entrepreneurial ventures when compared with other types of organizations.

All top management teams of entrepreneurial ventures are formed based upon complementary assets and resources. One member may be recruited because he or she provides the necessary financial, human, or social capital that other members may lack. However, this paper contends that *all* members must demonstrate positive psychological capital in order for the business to achieve both early-stage and long-term success. In fact, positive psychological capital may enhance the level at which a person utilizes his or her own human and/or social capital. Research indicates that positive psychological states are associated with good social relationships and one's ability to mobilize them during times of stress (Taylor and Brown, 1994).

It is important to remember that positive psychological capital is in regard to psychological states instead of traits, where a state involves behaviors, thoughts, and actions that can be learned and developed in almost anyone, while a trait is generally a quality that is enduring. The four psychological states used in this paper to represent the concept of psychological capital for an entrepreneur were hope, confidence, resilience, and optimism. When one considers the beneficial results that can take place in a business when all members genuinely demonstrate these states, it is easy to see why psychological capital is just as crucial as financial, human, and social capital for entrepreneurial success.

Clearly, however, these four psychological states must be measured empirically to determine how significant each state is alone and in conjunction with the other states in relation to entrepreneurial performance. Empirical research is needed to measure the aggregate effect of all forms of capital (see Figure 1).

Figure 1: Expanding Capital for Entrepreneurial Success



adapted from: Luthans, Luthans, and Luthans (2004) – "Expanding Capital for Competitive Advantage"

As one can see in the Expanding Capital Model of Entrepreneurial Success, an entrepreneurial venture must have financial capital to start along with the entrepreneur(s)' human capital (what he/she knows). The venture gains more strength with social capital (who the entrepreneur knows), and even more muscle when the entrepreneur is able to genuinely demonstrate positive psychological capital in order to more effectively mobilize the financial, human, and social capital available for success.

While the four psychological states presented in this paper are easily seen as significant for an entrepreneur to possess, it is important to bear in mind other positive psychological states. For example, *a sense of meaning* and *personal control* may also be appropriate to consider. These two states, along with optimism, are known to be protective of mental health (Kemeny, Reed, and Gruenewald, 2000) and they become even more important when one is faced with challenging events (Taylor, 1983). Other states may also be suitable to consider. However, the intention of this paper is to introduce the idea of psychological capital to the entrepreneurship literature by discussing the importance of the four states presented and discussed.

The important contribution of this paper was to introduce the concept of positive psychological capital and contend that it is as important to consider as all other forms of capital when examining short-term and long-term entrepreneurial success. The author hopes it will spark empirical studies in the area to advance academic and practitioner knowledge. In fact, the author plans to continue expanding the area by developing an instrument to empirically measure the impact of psychological capital on entrepreneurial success.

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IN IT FOR THE LONG HAUL?: SUCCESSION PLANNING WITHIN SMALL ENTREPRENEURIAL FIRMS

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ABSTRACT

Small businesses, whether family-owned or not, need to plan for the eventual turnover of key contributors, especially owners/founders. Those firms that have not implemented or communicated a formal succession plan may not have qualified people to lead them in the future. A study was conducted among small manufacturing firms to explore succession planning practices. Only 40% of the firms studied engaged in formal succession planning. Key determinants of succession planning were top-management support of the initiative and having someone who possesses the knowledge to adequately implement succession planning. For those firms that had a formal succession plan, what determined whether or not they kept it a secret from employees was whether they believed the employees included in the plan would feel a sense of entitlement to the promotion. The results are discussed and recommendations are made for the small business owner/consultant.

INTRODUCTION

It has been reported that no more than three out of every ten small businesses survive past one generation of leaders, and only 16% survive to the third generation (Janjuha-Jivraj & Woods, 2002; Watson & Everett, 1999; mall businesses failure, 1996). Certainly, economic/financial issues are responsible for a lion share of small business failures. Many others are caused by the inability of the firm to overcome the loss of key contributors (Lussier & Sonfield, 2004).

No matter how successful, every small business will, at some point, experience the loss of key contributors. Examples of such losses may be in the form of an engineer (whose skill-set may not be easily replaced) or a sales associate (who has built strong relationships with key customers over the years). Oftentimes, these losses are in the form of an owner/founder (whose vision helped build and sustain the culture). In fact, given that half of all U.S. small business owners are aged 60 or older (Fleming, 1997), it appears that planning for the eventual urning over of the reigns is more important than ever.

SUCCESSION PLANNING

Succession planning is a contingency plan an organization develops to address the eventual loss of key human resources. More specifically, it is he process of developing key people through a process that identifies candidates and tracks their progress and development (Nardoni, 1997). Succession planning has gained wider acceptance in the corporate world. Studies conducted show 67% of those surveyed reported that succession planning had grown in importance in the last decade (J. Howard & Associates, 2003). The emergence of succession planning in larger firms can be credited to the teamwork and bureaucracy needed to run a large organization. In addition, the corporate boards of large organizations have forced senior management to consider succession planning (J. Howard & Associates, 2003). One poll of executives found 100% of those surveyed believed it useful to identify and groom a successor. However, the same study found that only 72% were actually grooming people for these key roles (Messmer, 2002).

Small businesses have an even greater need for succession planning, but face unique challenges. First, key decision makers in small businesses can be more critical to the organization than key decision makers in larger corporations. Small businesses will rely on key decision makers more, while larger corporations generally have more management depth, processes, and procedures. Secondly, small businesses have a limited internal talent pool from which to draw, making replacing the loss of key decision makers more difficult. Yet, according to a study conducted by the American Society of Chartered Life Underwriters & Chartered Financial Consultants, less than half of all small businesses engage in formalized succession planning (mall businesses failure, 1996). Why? Perhaps some do not fully understand the necessity to prepare for the future. Others may argue they have neither the time nor money to invest in succession planning. Still, others may claim they do not possess the expertise to adequately implement succession planning. The reasons that small businesses fail to have proper succession plans are as different as the organizations themselves. These reasons need to be explored to understand why companies do not utilize this valuable tool.

SUCCESSION PLAN SECRECY

Even for those small businesses that engage in formalized succession planning, many are not getting the full ang for their buck because employees are not made aware that succession planning even exists within the firm. One survey concluded that less than 17% of organizations publicly shared the criteria to be selected to the succession plan. In addition many organizations showed a reluctance to inform employees that they had been selected for the succession plan (J. Howard & Associates, 2003). Those firms that keep their succession plans a ecret argue they do so in order to preserve employee morale, prevent incumbents from feeling threatened, and avoid successor entitlement.

If the employees selected for inclusion in the plan were made public, some were concerned it would poison the morale of those not chosen. Firms were also concerned about morale problems from those employees currently in the position (i.e., incumbents). Fear may develop among less confident employees that the organization was simply grooming their replacement, in preparation for forcing them out of the organization. This fear appears to be most common among longer tenured employees who feel some anxiety with their job security (Rothwell, 2001). Finally, some firms worry about giving mplied guarantees to those employees that are included in the succession plan. They are concerned that the employees may feel as if they had the promotion n the bag and, as a result, may not prepare themselves properly (i.e., not pursue development opportunities).

The challenges and demands upon today small businesses require the talents of highly qualified people. To ensure continued viability, it is the responsibility of a company leadership to plan for turnover. Those that have not implemented or communicated a formal succession plan may not have qualified people to lead their organization in the future.

METHODOLOGY

In an attempt to determine the extent to which small businesses engage in succession planning, and the reasons why they do or do not, an exploratory study was conducted among small manufacturing firms in Springfield, Missouri. Springfield, Missouri is experiencing the fastest rate of economic growth in the State

(Missouri Economic Research & Information Center, 2002). Small business is the backbone of that growth. Targeted firms were those manufacturers that employed 500 or fewer people. The Manufacturer Directory supplied by the Springfield, Missouri Chamber of Commerce was used to identify the survey population (N=100).

Personal phone calls were placed to each of the 100 manufacturers that fit the parameters of the study; the owner, general manager, or human resource manager (if the position existed) was requested. The purpose of the study was explained and, for those that agreed to participate (N=48), a questionnaire containing 25 items was sent and returned via fax. Table 1 provides some descriptive statistics on the 48 respondent firms. The mean number of employees among the forty-eight respondent firms was 154; median number of employees was 100.

Table 1: Participant Firm Descriptions

Firm Size (# of employees)			
Range	22-500		
Mean	154		
Median	100		
Organizational Attributes		NO	YES
Track employees when they acquire more skills/training?		10 (21%)	38 (79%)
Formalized Succession Plan?		29(60%)	19(40%)
		YES	NO
Is Succession Plan Secret?		9	10

RESULTS

While 38 (79%) out of the 48 respondents indicated they track employees when they acquire more skills/training, only 19 (40%) of the 48 indicated they had a formalized succession planning process. Firm size had no impact on the propensity to engage in formalized succession planning as the results of a z test performed on the proportions of those firms with less than 100 employees engaged in succession planning compared to those with 100 or more employees were not statistically significant. In addition, of the 19 firms that indicated they had a formalized succession plan, almost half indicated they keep the plan secret from employees.

DETERMINANTS OF SUCCESSION PLANNING

In an attempt to determine the main reasons why the respondent firms did/did not engage in succession planning, a logistical regression analysis was conducted on the responses to those items on the questionnaire offering possible explanations. Logistical regression was used in this case due to the non-linear nature of the dependent variable (i.e., one requiring responses of yes/no), which violates one of the assumptions of linear regression. Logistical regression transforms a non-linear relationship into a linear one and allows for the interpretation of the data similar to a ormal regression equation (Cohen & Cohen, 1983). Table 2 lists the five pertinent items and the resulting statistical significance associated with each. As can be seen in Table 2, two variables were statistically significantly related (at $p< .05$) to the respondent firms decisions whether or not to engage in formalized succession planning: they were ur organization leadership understands the value of formalized succession planning and ur organization lacks the knowledge to adequately implement a succession plan (which was negatively related, as expected). Together, these five variables explained roughly 52% of the variation in decisions whether or not to engage in formalized succession planning.

Next, for those firms that indicated they engage in formalized succession planning, an attempt was made to determine why they did/did not keep the plan a secret. The data analyzed was limited to those 19 firms that engaged in formalized succession planning. Another logistical regression was run (for the same reasons as stated before): this time the dependent variable was a Likert-type item with 5 response choices; there were 3 Likert-type independent variables (also with 5 response choices each) included in the analysis. Table 3 lists those 3 items and the resulting statistical significance associated with each. As can be seen in Table 3, one of the items was statistically significantly related (at $p< .10$; given the smaller sample size included in this analysis, the decreased statistical power warrants accepting a larger Type I error) to firms decisions whether to keep their succession plans a secret: it was e are concerned that employees who know they are potential replacements will automatically assume they have the position Together, these 3 variables explained roughly 38% of the variation in decisions whether or not to keep the plan a secret.

Table 2: Logistic Regression Analysis of Possible Explanations on Succession Planning				
Independent Variables	Regression Coefficients	Std. Error	t-value	Pr(>t)
Intercept	1.91	.32	6.00	0.00
Turnover as a threat	0.07	.05	1.44	0.16
Top-management support	0.26	.05	4.98	0.00
Lack adequate knowledge	-.12	.06	-1.98	0.05
Insufficient Budget	-.03	.05	-.047	0.64
Insufficient Time	-.01	.06	-0.25	0.81
Multiple R-squared: 0.52				
F statistic: 8.94 with 5 and 42 degrees of freedom; the p value is 0.00				

Table 3: Logistic Regression Analysis of Possible Reasons for Plan Secrecy				
Independent Variables	Regression Coefficients	Std. Error	t-value	Pr(>t)
Intercept	4.79	0.72	6.69	0.00
Damage Employee Morale	0.14	0.20	0.70	0.50
Incumbents Threatened	0.31	0.32	0.98	0.34
Entitlement	0.43	0.24	1.78	0.09
Multiple R-squared: 0.38				
F statistic: 3.11 with 3 and 15 degrees of freedom; the p value is 0.05				

DISCUSSION

The finding that only 40% of the respondent firms engaged in formalized succession planning is consistent with prior research findings. A national survey conducted by the life insurance and financial services industry revealed that a majority of agents polled indicated that more than half their small business clients lacked business succession plans (mall businesses failure 1996). However, it is surprising that the proportion of small businesses engaged in succession planning has changed relatively little in the past 9 years, especially considering the volatility of the small business landscape during that time span. Nevertheless, this finding does not diminish the importance for small business to have a formalized succession plan (onfamily firms 1992); it merely amplifies the extent to which small business must heed the message.

One item that was significantly related to whether the respondent firms engaged in formalized succession planning was about top-management support. As Rothwell (2002) indicates, the first step toward implementing an effective succession plan for an organization is to fully support the succession planning process. The leadership must send clear messages, and support it with the resources that are needed. So, without top-management support, the implicit message becomes uccession planning is not valued here and any efforts directed towards it will not be recognized or supported Related to this, it is interesting to note that among those 22 respondent firms that indicated a lack of top-management support for succession planning, 17 (77%) indicated that a majority of their employees were not proactively preparing themselves for advancement. Is it any wonder?

The other item that was significantly related to whether the respondent firms engaged in formalized succession planning was about having the proper resources (knowledge) to implement succession planning. Typically, succession planning falls within the purview of the Human Resources discipline. However, it is entirely possible that many of those responsible for ypical HR issues (such as selection, training, performance management, etc.) among the respondent firms were not formally trained in Human Resources. In many small businesses, many different ats are worn by those in leadership positions due to resource constraints placed upon the firm. Without someone formally trained in HR, it is possible those firms were reluctant to even think about succession planning for fear they lacked the necessary expertise. In this study, since the presence of a ormally-trained HR manager was not determined, the explanation provided for this finding remains speculation.

It is interesting to note those items that were not significantly related to whether the respondent firms engaged in formalized succession planning: insufficient time, inadequate budget, and viewing turnover as a threat. Among the 48 small manufacturing firms that responded, only 14 (29%) believed they did not have either adequate time or money to devote to succession planning. So, that means, even among those that do not engage in succession planning, their decisions were not affected by these two resources that are typically given as reasons why small businesses do not engage in particular activities. Only 9 (19%) of the respondent firms indicated they would not view turnover in key positions as a threat to the organization. So, it appears that most small businesses understand the importance of succession planning, but other things get in the way (such as those mentioned above: not having top-management support and not having the knowledge to successfully implement succession planning).

Even when firms engage in succession planning, they vary with regards to whether or not employees are made aware that the plan exists and whether or not they are included in the plan. From this study, it appears that the driving factor behind this decision is whether the firm believes that employees, if told about their inclusion in the plan, will feel a sense of ntitlement to the promotion. Among the 19 respondent firms that engage in formalized succession planning, 9 (47%) kept their plans secret (apparently for the reason stated above). This is consistent with a previous study which found that 46% of surveyed firms with succession plans did not inform those employees included in the plan (J. Howard & Associates, 2003). However, keeping the plan a secret may be shortsighted. If employees are being targeted for promotion (regardless of the timeline associated with it), but don know it, they may not pursue the developmental opportunities necessary in order to acquire the knowledge, skills, or abilities required before being designated as eady immediately for promotion

RECOMMENDATIONS FOR THE SMALL BUSINESS OWNER/CONSULTANT

The findings from the present study can be used to make several recommendations:

1. Someone within the firm leadership must take ownership of the succession planning process and become its hampion An organization whose leadership does not support succession planning will be the least prepared

for turnover in key positions. The support must be more than just vocal in nature. The leadership must give the individuals involved in the succession planning process the resources necessary to adequately do the job (Rothwell, 2002). Perhaps providing training for those in leadership positions on the value and necessity of succession planning would increase the likelihood of a stronger commitment to succession planning and devotion of more financial resources.

2. Requisite knowledge to adequately implement succession planning must be in place. In a similar regard, leadership can ensure the firm has the requisite knowledge to adequately implement a succession plan by employing Human Resource professionals that have been trained and are experienced in succession plan implementation. Such employment may be by filling full-time positions within the firm or by contracting with outside HR consultants on a project basis.

3. Firms need to worry less about entitlement and more about survival. Once the firm has made a commitment (both symbolically and financially) to succession planning, it needs to publicize the plan within the firm (especially to those selected for inclusion in the plan) in order to maximize its effectiveness. An open discussion with appropriate documentation in the personnel file should help eliminate the fear of a perceived guaranteed promotion. It needs to be explained to employees that a succession plan is not a promise, contract, or guarantee of future employment or advancement, but it is a contingency plan.

4. Once the employee clearly understands succession planning processes, the firm should inform the employee of the options available or actions that could be taken to address current skill deficiencies. The firm must be honest about what work is required for the position, and what assistance the firm will provide. Many firms perform individual development plans, called IDPs. These IDPs are designed to be maps for the employees so they can build the competencies needed to fill a higher-level position. Special forms of recognition would encourage key employees to complete these IDPs. Related research found that even key employees were less likely to grow their talent if they received no rewards for doing so (Rothwell, 2002). In Springfield, the Megavolt Corp. is an example of a local business that

awards a bonus for certain levels of employee growth. Also, SRC Corporation rewards employees that earn a Master Degree with a sizeable monetary bonus.

CONCLUSION

The findings of the study described herein indicate that most small manufacturing firms do not engage in formalized succession planning due to lack of top management support and the requisite knowledge to effectively implement succession planning. For those firms in the minority that do engage in succession planning, it appears that many keep their plans a secret from employees out of fear that, should those who have been chosen for inclusion in the plan find out, they will feel a sense of entitlement to the promotion. Of course, this study only looked at small manufacturing firms within a particular region (Springfield, Missouri). Whether the region under study is representative of other regions remains under question. In order to determine whether these results can be generalized, future studies are warranted which look at small manufacturing firms from various regions across the country (and perhaps internationally as well). Future research may also wish to identify the specific issues behind firms beliefs that they lack the knowledge to adequately implement succession planning.

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CROSSING THE LINE: EXPRESS WARRANTY OR MERE SALES TALK?

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ABSTRACT

The words used by sellers to describe their goods to induce buyers to purchase them can land the seller in court if the goods fail to measure up and the language is deemed to create an express warranty. Not all representations, however, create an enforceable express warranty. Sellers are given leeway to praise the value of their goods and to express opinions or commendations about them without exposure to liability. This freedom to praise is variously called "puffing", "shop talk", "salesmanship", and the like. The task of distinguishing sales talk from warranting is not an easy one and conflicting court decisions have resulted. Nevertheless, an actionable express warranty has structure and is comprised of the simultaneous existence of three elements. When these elements are applied to specific sales language a reasoned conclusion about whether the language is puffing or warranting can be determined. The purpose of this paper is to commend a process and identify the tests for distinguishing permissible salesmanship from actionable warranting. This paper also suggests an additional approach for determining whether warranty language fulfills one of the essential requirements that it be a part of the basis of the bargain.

INTRODUCTION

In the early 1990's Robbie Moore visited the Berry Sporting Goods store in Griffin, Georgia, to buy a tree-climbing stand. Mr. Berry and his sales clerk showed Mr. Moore a stand and said the model was "probably the safest one on the market" and there is "no way you can fall in this stand". Based in part on these statements, Mr. Moore purchased the stand. When put to use, the tree stand collapsed causing Mr. Moore to fall from a tree. Mr. Moore sued Berry Sporting Goods for his injuries. He alleged that the statements made to him by Mr. Berry and his clerk amounted to an actionable express warranty that the tree stand would conform to their representations. The trial court decided that the statements made by Mr. Berry were too vague, were mere sales talk or "puffing", and did not constitute an enforceable express warranty. The appellate court reversed the decision and observed: "We find the representations that the tree stand is "probably the safest one on the market" and "there is no way you can fall" from it, upon which Moore relied, sufficient to raise a jury question as to whether they were an intentional affirmation relating to the quality of the tree stand such that an express warranty was created." (Moore v. Berry, 1995). This case illustrates the uncertainty about express warranty liability for statements made by sellers in the sales arena. The trial court decided that the statements were mere salesmanship and were not actionable. The appellate court decided otherwise. How, then, does one distinguish innocent sales talk from actionable warranting?

DISCUSSION

In the context of contracts for the sale of goods, a warranty has been defined as a promise or an agreement by the seller that the article sold has certain qualities (Chanin v. Chevrolet Motor Co., 1935). Failure of the goods to conform to the promise or agreement subjects the seller to liability for damages proximately caused by the breach (Lindemann v. Eli Lilly and Company, 1987). Pursuant to the Uniform Commercial Code – Sales (U.C.C.), an express warranty is created when the seller makes an affirmation of fact or promise that relates to the goods and becomes a part of the basis of the bargain between the parties that the goods will conform to the affirmation or promise (Uniform Commercial Code 1978, §2-313(1)(a); Royal Business Machines, Inc. v. Lorraine Corp., 1980). No special language like "guaranty" or "warranty" is required and even catalog descriptions and advertisements may create an express warranty (Overstreet v. Norden Laboratories, 1892). Not every representation made by a seller about his goods, however, creates an express warranty. The law provides sellers with a good deal of leeway to subjectively boast about their goods without exposure to liability. Cases interpreting the Uniform Commercial Code frequently find that certain kinds of statements made by sellers are mere "puffing" and that these kinds of general statements of salesmanship do not create enforceable express warranties (Omega

Engineering, Inc. v. Eastman Kodak Company, 1998). Section 2-313(2) of the U.C.C. specifically provides that statements purporting to be merely the seller's opinion or commendations of the goods or relate only to the value of the goods do not create a warranty (Uniform Commercial Code 1978, §2-313(2). In short, statements of salesmanship that are opinions, puffery and other similar language are not express warranties and are not actionable as such (Anderson v. Bungee International Manufacturing Corp., 1999). Making the distinction between statements about goods that are warranting because they constitute an affirmation of fact or promise that are part of the basis of the bargain from statements that are words of salesmanship is problematic (Meadows, Dessin, and Garvin, 2004). However, cases interpreting the U.C.C have provided a framework together with several factors that can be employed to reach reasoned conclusions about whether a seller's representations are actionable as express warranties. Curiously, the court opinions in this field seldom involve basic concepts of contract formation and a comment about this issue will follow the discussion of "settled law" below.

Express Warranty: The Elements

An express warranty is comprised of three elements. The elements are: (1) an affirmation of fact or a promise; (2) which relates to the goods; (3) and becomes a part of the basis of the bargain (Royal Business Machines, Inc. v. Lorraine Corp., 1980). When each of these elements is present, an enforceable express warranty is created that the goods will conform to the affirmation of fact or to the promise. However, an express warranty cannot be formed if any one of the three elements is lacking. Therefore, a reasoned approach for distinguishing warranting language from mere sales talk is to apply each element to the questioned sales language in the order enumerated.

Element One: Affirmation of Fact or Promise

When confronted with incidences involving statements that are claimed to be express warranties by the buyer and defended as mere sales talk by the seller the initial focus must be upon the first element. If the sales language is not an affirmation of fact or promise then no express warranty can exist. The courts have employed several tests in making this initial determination. The tests include the Ignorant Buyer Test; the Inducement Test; Factors Tests; and Precedent.

Ignorant Buyer Test

While the existence of an express warranty depends upon the particular circumstances in which the language is used, one test applied by some courts for determining whether a given representation is an affirmation of fact or a promise is "whether the seller assumes to *assert a fact of which the buyer is ignorant* or whether he merely states an opinion or expresses a judgment about a thing as to which they may each be expected to have an opinion and exercise a judgment." (Overstreet v. Norden Laboratories, Inc., 1982, emphasis supplied). General statements to the effect that goods are "the best" or are "of good quality" or will "last a lifetime" and be "in perfect condition" are generally regarded as expressions of the seller's opinion because both the buyer and the seller would presumably be expected to have an opinion or exercise a judgment concerning the import of such phrases (Royal Business Machines, Inc. v. Lorraine Corp., 1980). However, the generality of the statement is not always conclusive. For example, where the salesman told the buyer that a motor camper was "in excellent condition" the statement was held to be an affirmation of fact or promise and therefore an express warranty because the seller's knowledge about the condition of the goods coupled with the buyer's relative ignorance concerning same elevated the statement from mere praise to a fact (Valley Datsun v. Martinez, 1979). Generally, when the sales statements relate to certain performance capabilities of the goods about which the seller has superior knowledge and where the buyer is comparatively less informed, such statements will likely be deemed affirmations of fact and not mere opinions (Tralon Corporation, Soil Remediation Service, Inc. v. Cedarapids, Inc., 1997). The key inquiry here is whether the sales language contained statements about which the buyer was uninformed, or whether the statements were something about which both the buyer and the seller could have an opinion (Mazzuocola v. Thunderbird Products Corp., 1995 U.S. Dist LEXIS 6883, 1995). In the latter case no affirmation of fact or promise will be found to exist.

Inducement Test

The affirmation of fact or promise can also be distinguished from mere opinion by determining if the natural tendency of the statement is to induce a reasonable buyer to purchase (Daley v. Mc Neil Consumer Products Co., 2001). For instance, in a case holding that "Made in the U.S.A." and "premium quality" were not affirmations of fact the court held that at a minimum the buyer must show that there was an affirmation of fact or promise by the seller, the natural tendency of which was to induce the buyer to purchase (Anderson v. Bungee International Manufacturing Corp., 1999). The court reasoned that the phrases "Premium Quality" and "Made in the U.S.A." to the extent that they connoted superior quality were not descriptions or characteristics of the goods upon which a reasonable consumer would rely as statements of fact inducing him to buy. Therefore, statements of the type that are generalized and exaggerated upon which a reasonable consumer would not rely as factual like "popular", "most dependable" and "Like a Rock" will not be deemed to be affirmations or promises (Hubbard v. General Motors Corporation, 1996). The inducement test focuses on whether it is apparent from the sales language that the claim made by the seller was in the mind of the buyer and that the buyer contemplated the claim and reasonably accepted it as true in making the decision to purchase (Spiegel v. Saks 34th Street, 1964).

Factors Tests

In drawing distinctions between shop talk and affirmations of fact or promises the courts have established some factors that are deemed helpful. Because the line between puffing and warranting is often difficult to draw it has been held that the more specific the statement the more likely it will be deemed to constitute an affirmation of fact (Downie v. Abex Corporation, 1984). In his article, Beyond Puffery (1995), Shapiro points out that vague or highly subjective claims about the superiority of a product rather than detailed factual assertions are more likely to result in a finding that such statements are puffery rather than affirmations of fact or promises. For example, the term "rock-solid" used to describe a fiberglass tractor roof that was crushed in a roll-over accident was held not to be an affirmation of fact because "consumers know that vehicles that are 'rock-solid' will be dented by an impact that would not dent a rock." (Jordan v. Paccar, Inc., 1994). By contrast, the phrase "fail-safe" in reference to a ball-screw assembly used to support an airplane passenger loading bridge was held to be an affirmation of fact when the ball-screw assembly failed causing the bridge to collapse because the seller specifically emphasized that the assembly would prevent the collapse of the bridge (Downie v. Abex Corporation, 1984). In addition, courts also consider whether the sales statement was written or oral the latter being more likely to be considered puffing (Omega Engineering v. Eastman Kodak Company, 1998). On this same point, the Supreme Court of Washington delineated the factors it wanted a trial court to consider in determining if the words "built tough for long lasting, reliable performance" and "will stay ready and roadworthy in all kinds of weather and work environments" were affirmations of fact or promises. That court enumerated the following factors to consider in making this decision: (a) the specificity or generality of the statement; (b) the statement's relation to the quality of the goods; (c) whether the seller hedged in the statement; (d) whether the product was experimental; (e) whether the buyer had actual or imputed knowledge of the true condition of the goods; and (f) whether the goods were, in fact, defective (Federal Signal Corporation v. Safety Factors, Inc., 1994)

Precedent

It is probably fair to say that courts are most comfortable with citing precedent involving the same or similar sales language in support of their conclusion that the language at bar is or is not an affirmation of fact sufficient to create an express warranty. The difficulty with this approach is that courts have reached decisions that are inapposite when determining the legal effect of sales statements that involve similar language. This topic is so fact intensive that each side will probably be able to find cases supporting their claim. General statements to the effect that goods are "the best" of are "of good quality" or will "last a lifetime" and be "in perfect condition" are usually determined to be expressions of the seller's opinion or "the puffing of his wares" (Royal Business Machines, Inc. v. Lorrane Corp., 1980). However, precedent can be cited in which those same or similar phrases were deemed to have crossed the line and were found to be affirmations of fact that created enforceable warranties (Pierson, 1998). Therefore, while the use of precedent to compare, analogize and make distinctions between puffery and warranting is a common practice it is also a method fraught with ambiguity.

Element Two: Relates to the Goods

If, after using one or a combination of the tests listed above, the sales statement at issue is found to be words of salesmanship involving the seller's opinion or commendation of the goods then the inquiry ends and no express warranty can be imposed because the statement was not an affirmation of fact or promise. For example, the phrase "You meet the nicest people on a Honda" would likely not meet the tests of warranty language discussed above (Federal Signal Corporation v. Safety Factors, Inc., 1994). If, on the other hand, the statement is found to be an affirmation of fact then the second element must be satisfied. That is, did the statement relate to the goods? For example, where a boat seller furnished the buyer with speed data for one type of boat which data did not relate to the particular type of boat ultimately purchased by the buyer the court held that the speed data did not create an express warranty because the data did not relate to the goods at issue (Bayliner Marine Corporation v. Crow, 1999). Generally, the "relates to the goods" element is not often contested in cases where express warranty is claimed. It is usually conceded that the statements related to the goods but that such statements were puffing and not warranting. However, a caveat should be noted that statements that discuss the future performance of goods are not actionable as express warranties. It has been held that sales statements that refer to some future time that goods will conform to particular characteristics without clearly specifying when the goods will conform then such statements will be deemed not to relate to the goods (Cuthbertson v. Clark Equipment Company, 1982).

Element Three: Basis of the Bargain

The third element, that the affirmation or promise must become part of the basis of the bargain, has been said to be difficult to ascertain but is an essential and required element in order to create an express warranty. The mere existence of warranty language is insufficient to sustain an action for breach of an express warranty unless the warranty is "part of the basis of the bargain" between the parties (Overstreet v. Norden Laboratories, Inc., 1982). In the mainstream, it has been held that in order for the seller's statements to become part of the basis of the bargain the statements must be relied upon by the buyer as one of the inducements for purchasing the goods (Overstreet v. Norden Laboratories, Inc., 1982). Under the former Uniform Sales Act, the seller's statement was required to induce the buyer to purchase the goods so the element of reliance was specifically included (Uniform Sales Act §12, 1943). But, under the current U.C.C., while there is no requirement that the buyer rely upon the seller's representations, many courts continue to require reliance to establish that the statement was part of the basis of the bargain (Compaq Computer Corporation v. Lapray, 2004). For example, in the introductory case, Moore v. Berry (1995), the court said that "the decisive test" in determining whether sales language is a mere expression of opinion or a warranty is whether the sales statement "purported to state a fact upon which it may fairly be presumed the seller expected the buyer to rely and upon which a buyer would ordinarily rely". In short, the traditional rule is that there exists little difference between "basis of the bargain" and a finding that the buyer relied upon the seller's statements in making the decision to purchase (Royal Business Machines, Inc. v. Lorraine Corp., 1980). This mainstream treatment of the issue continues despite the apparent intention of the drafters of the U.C.C. not to require a strong showing of reliance. In fact, a split of authority has arisen about whether an official comment to U.C.C. 2-313 dispensed with the requirement that a buyer rely on the sellers statements in order to create an enforceable express warranty (McManus v. Fleetwood Enterprises, Inc., 2003). This split occurred because Comment 3 to U.C.C. 2-313 provides: "In actual practice affirmations of fact made by the seller about the goods during a bargain are regarded as part of the description of those goods; hence no particular reliance on such statements need be shown in order to weave them into the fabric of the agreement" (Uniform Commercial Code 1988, §2-313 cmt. 3). Notwithstanding this language, courts have continued to hold that a buyer's reliance upon the seller's statement to some extent is required in order for the statement to be part of the basis of the bargain and fulfill the third element for enforceable express warranty (Henry Schein, Inc. v. Stromboe, 2003).

Basis of the Bargain: Mutual Assent

In light of the foregoing, perhaps another approach to finding "basis of the bargain" is in order. There seems to be a sense that the process of finding the existence or non-existence of express warranties is a matter which is ancillary to the substantive contract for the purchase of the goods. Should the express warranty be considered a separate covenant or should it be considered as a full partner with the other terms of the sales agreement? If an express warranty is deemed to be a very part of the formation of the entire sales contract then disputes about its existence and questions about whether it is part of the basis of the bargain would be determined in the same way that other contractual terms are treated.

Article 2 of the Uniform Commercial Code is comprehensive and governs all aspects of contracts for the sale of goods. U.C.C 2-204 provides in part that a contract for sale of goods may be made in any manner sufficient to show agreement (Uniform Commercial Code 1978, §2-204). A case arising under the U.C.C. teaches that a basic element for a sales contract is that both parties assent to the same thing in the same sense and that their minds meet on the essential terms and conditions of the agreement (Interstate Industries Inc. v. Barclay Industries, Inc., 1976). This case provides that the first step toward mutual assent is an offer by one of the parties and that mutual assent occurs when that offer has been accepted by the other party. An offer is a promise. A promise is also an express warranty if it relates to the goods and is part of the basis of the bargain. A “meeting of the minds” is proved when the evidence shows “with reasonable definiteness that the minds of the parties met upon the same matter and agreed upon the terms of the contract (Steele Benders, Inc. v. H.R. Braner Engineering, Inc., 1988). Therefore, it is submitted that the “basis of the bargain" inquiry should involve whether the minds of the seller and buyer met upon the affirmations or promises made by the seller and, if so, then such affirmations or promises would be a part of the basis of the bargain. In support of this kind of analysis, reference is made to comment one to U.C.C.2-313 which provides in part that: “Express’ warranties rest on ‘dickered’ aspects of the individual bargain.” (Uniform Commercial Code 1988, §2-313 cmt. 1). “Dickered” connotes that the parties engaged in negotiations and the offer/acceptance process in forming the sales contract. Thus, where the parties negotiated over the seller’s sales message and reached a meeting of the minds about it then the sales language should be deemed to be part of the basis of the bargain. For example, in McLaughlin v. Denharco (2001), McLaughlin purchased a tree delimbing machine manufactured by Denharco. Denharco provided certain promotional literature and videos which were examined by McLaughlin. The promotional material stated that “maintenance is reduced to a minimum and lubrication is no longer necessary” and that the machine was ideal for the “challenges of large diameter stems, softwood even hardwood”. The delimbing machine failed to conform to these representations and McLaughlin sued for breach of express warranty. Denharco claimed the language contained in its promotional material was puffery. In response, McLaughlin showed that he read the literature and viewed the video and that the parties “dickered over” the promotional claims. The court determined that a jury could find that the statements created an express warranty. The court observed that there was evidence that the statements were “dickered” over and this fact supplied proof that the seller’s representations became a part of the basis of the bargain.

SUMMARY AND IMPLICATIONS

The language selected and used to induce the purchase of products can result in liability if the goods fail to measure up to the claims. It makes no difference if the sales language is verbal and takes place on the sales floor or is found in written or media materials, liability will be imposed if the language is found to create an express warranty. The U.C.C. plainly establishes a seller’s liability for language that is deemed to be an affirmation of fact or a promise when that language is part of the basis of the bargain. The U.C.C. also provides that no liability shall exist for sales language that relates only to the value of the goods or constitutes the mere opinion or commendations of the goods by the seller. The problem is that despite this statutory law the line between puffing and warranting is difficult to draw. There are simply too many variables to assure absolute predictability. A sophisticated buyer could help his warranty case if he insisted that the seller write on the back of the bill-of-sale: "Seller acknowledges that he told the buyer that this product is in A-1 condition, the parties negotiated this matter, and the buyer relied somewhat on this statement as an inducement to buy it". A sophisticated seller, wishing to avoid express warranty liability, could change the language ever so slightly to read: "In seller's opinion this product is in A-1 condition…" and the balance would be tipped in seller's favor.

Nevertheless, business professionals, both sellers and buyers, wishing to manage express warranty and practitioners wrestling with the import of specific sales language after an express warranty claim is made, can profit from analyzing the given sales language against the framework and factors identified above. The elements for express warranty suggest that three questions be posed about the sales representation at issue. One: Does the sales message contain performance claims or include specific product characteristics about which the seller has superior knowledge that would induce an ordinarily prudent consumer to buy? Two: Does the sales message relate to the specific product? Three: Is the sales message believable so that it would reasonably induce consumer assent and will consumers rely in some measure on the message in making a decision to buy? An affirmative response to all three questions will be an indication that the sales language under review will likely be deemed an express warranty.

From a pragmatic standpoint the elements analysis teaches sellers wishing to reduce express warranty liability to train sales staff to present product attributes as opinions or to the best of their knowledge rather than making bold statements of fact or expressing firm promises. The express warranty elements analysis can also help advertisers and writers of advertising promotional literature determine in advance whether the proposed sales language is an affirmation of fact or words that merely commend the value of the goods. On the other hand, buyers seeking the protection of the express warranty law can employ the elements analysis and insist on specificity; can document the negotiations and the seller's language; question and dicker over the claims; and show some element of reliance on seller's statements as an inducement to purchase. In the final analysis, the objectives of either buyer or seller concerning express warranty can be furthered by use of the framework and factors analysis posited here. It is submitted that the foregoing template can provide a useful and reasoned approach to determining whether specific sales language has or will cross the line between puffing and warranting.

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SALES EFFECTIVENESS AND FIRM PERFORMANCE: A SMALL FIRM PERSPECTIVE

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ABSTRACT

The purpose of this exploratory study was to examine the relationship between sales effectiveness and small firm performance in a time when a proliferation of technological innovations are available for use by salespeople. One such innovation, CRM systems, will be focused on in this study. A multi-item construct of sales effectiveness was linked to three non-financial performance measures. Over sixty sales representatives were surveyed and the regression analysis was used to examine the data. The results suggested that different sales effectiveness variables—resource management, perceived usefulness, perceived ease of use, general attitude toward technology and comfort level are significantly and positively associated with small firm performance.

INTRODUCTION

The number of small business startups has continued to rise in the 21st century. Statistics collected by the U.S. Small Business Administration reveal that over 23 million companies have been classified as "small" and responsible for the creation of three-quarters of the country's net job growth (Acs and Arrington 2003). However, government statistics have also suggested that the staying power and ultimate survival of these businesses is still an ongoing concern. More specifically, it is estimated that about two-thirds of new small firm ventures have survived at least two years, while only half continue to exist after at least four years. While many of the firms closing their doors were profitable and thriving, the overwhelming majority of these firms shut down due their inability to garner the resources needed to sustain their competitiveness (Headd 2001).

Based on the continued reliance on and prominent role of the small business sector for economic development, it is essential to understand how resources utilized by small firms help them to remain competitive. The head of the Small Business Adminstration, Hector Barreto, has set forth a challenge to all of the firms under his domain to find innovative ways for becoming more customer-centric (Guadalupe 2003). He, himself, has openly discussed plans for his organization to be at the forefront of the utilization of technological innovations in order to create a more customer-focused Small Business Administration. Integral to his plans is the implementation of the appropriate configuration of information and communication technologies needed to increase his organization's responsive to the needs of his small-business customer base.

Technological advancements are allowing businesses of all sizes to develop the means for becoming more customer-driven. For instance, the transformation of the traditional marketplace into a vast marketspace now facilitates relations between buyers and sellers devoid of time, place, and occasionally costs constraints (Brannback 1997). The enabling role of information and communication technologies (ICT) has helped to simplify business processes and made it easier for sellers to supply information to current and potential customers, process their orders, as well as conduct the necessary business activities that promote long-term customer relationships. This can be particularly beneficial to the many small companies which strive to emulate the responsiveness and professionalism of larger firms that have the luxury of having more resources.

Over the past decade, several studies have concluded that the enabling role and use of technological advancements in the sales job has profoundly impacted the field of selling (Moncrief et. al. 1991; Marshall et. al. 1999). Communication with customers has been enhanced with products ranging from cellular phones to virtual meeting rooms, and information of all types can now be accessed with the push of a button. This is especially noteworthy due to the fact that salespeople often serve as the primary linkage between marketers and their customers.

By and large, an increased presence of technological offerings has altered the manner in which conventional sales activities are performed while facilitating the creation of many new sales activities. The growth in the utilization of such technological advancements in the performance of the sales function coincides with the mounting focus on strengthening relationships with customers. Salespeople are the primary conduit between firms and their customers, and it is mostly due to their actions that successful business relationships arise (Peterson 1999).

Marketers of customer relationship software have taken notice of the challenges sales representatives in small firms face in managing relationships with customers. Vendors such as Oracle, SAP AG, Microsoft and Salesforce.com, among others, are now aggressively targeting small firms with scaled-down versions of their CRM software applications (with embedded sales force automation tools) that were originally developed to enhance the relationship management capabilities of large corporations. Spending by small businesses on CRM/sales force automation products is expected to drastically increase over the next few years (Anonymous 2004).Yet; the diffusion of such feature-rich applications in the small business environment could be stifled if the ultimate users of such software do not realize their benefits.

Since the activities of the sales force have been found to be directly tied to customer satisfaction and relationship marketing in many firms (Smith and Barclay 1997), it is important to examine how the viewpoints of salespeople impact the use of the technological tools that they are given to perform their jobs and their relative impact on firm performance. Several studies conducted have focused on a similar line of inquiry by looking at both technology-based and nontechnology-based sales tools in large company settings. The purpose of this exploratory study, therefore, is to provide insights to small firms on whether the technological advancements integrated into their sales processes positively impact the performance of their sales representatives as well as overall business performance.

The results of this research can help small business managers and owners better support the efforts of their salespeople in meeting both customer and company needs. Additionally, vendors can use the results to develop appropriate strategies for designing and selling technological products and services to small companies often deemed reluctant to spend money on, install and update information and communications technologies (Hopkins 2001).

LITERATURE REVIEW

An underlying question that all firms must consider is how to sustain competitiveness. The field of strategic management is replete with theories on this topic, one of which is rooted in understanding how the organizational strengths and weaknesses of firms might build enduring advantages (Wernerfelt 1984). An important element of this particular school of thought is the creation of firm specific capabilities that serve as key determinants of firm performance. Stack, Evans, and Shulman (1992) concluded that successful outcomes are possible when 1) key resources, such as technologies and organizational processes, are transformed into strategic capabilities that deliver superior value, and 2) firms invest in a support infrastructure to build such capabilities. This perspective looks at capabilities as a basis for determining how efficiently and effectively an organization carries out its business activities. Success is achieved if a firm manages to gain the appropriate resources for developing the capabilities which allow it to perform in a superior manner.

This standpoint coincides with Barney's (1991) notion that resources and capabilities are valuable when they allow firms to formulate or implement strategies that enhance business performance. Given that each firm builds its own configuration of business resources, and the fact that some of these resources have more strategic value than others (Barney 1996), businesses that exploit their resources to develop superior capabilities stand to positively impact their performance. This is because resource-based capabilities enable companies to build and execute strategies that increase organizational efficiency and effectiveness. Thus, when viewing the sales function from a resource-based perspective, a firm's sales processes as well as the resources supporting the sales function should be integral to competitive positioning.

Sales Activities Research

Studies delineating activities performed by sales representatives' date back to the 1960s when McMurray (1961) and Newton (1973) performed seminal research to examine the widely held notion that sales professionals, in general, carry out a distinct set of activities that are fundamental to any sales job. While both were able to categorize salespeople into distinct groupings, it remained unclear as to how sales activities differed among their classification schemas. Follow-up studies were conducted in the 1970s that began to shed light on the defining elements of the sales job. Upon interviewing the sales force of a large corporation and identifying approximately 60 activities performed by their sales professionals, Lamont and Lundstrum (1974) found the results could not be generalized to sales positions in other firms. Likewise, Churchill, Ford, and Walker (1978) uncovered an operative set of tasks executed by sales representatives that fell short in explaining the specific activities performed in different sales jobs.

Noting the lack of specificity in previous research, Moncreif (1986) used a cross-industry perspective to generate a comprehensive list of tasks regularly performed by sales personnel. An analysis of data obtained from one-on-one interviews and focus groups resulted in a list of 121 specific sales activities considered *mutually exclusive* by the researcher. The activities cited included a wide-range of actions such as 1) prospecting, preparing sales presentations and other undertakings traditionally associated with the personal selling and relationship marketing processes; 2) politicking within the company and other internal selling duties; 3) a myriad of territory management and administrative responsibilities; 4) knowledge acquisition, training, and additional professional development activities and 5) many other meaningful activities.

In 1999, Moncreif et. al. updated the list of sales activities to account for changes in the selling environment. Global competition, partnering relationships, multiple sales channels and the like have had a profound impact on the sales job which has become more complicated. As sales representatives have struggled to handle complexities, 49 new sales activities were discovered in the more recent study that did not materialize beforehand. Further analysis of the data revealed substantial use of technology-based sales tools in performance of selling tasks.

Subsequently, sales activities significantly impacted by technology were placed into five main categories—communication, sales, relationships, team-building/team-selling, and database management. Each category is discussed below.

Effective communication between sales professionals and key business constituents is essential for addressing customer needs. Overall, technologies have allowed salespeople to become more mobile while decreasing the "downtime" they have often experienced due to nonproductive periods caused by travel, waiting, and other disruptions. Cell phones and/or pagers have become a prerequisite for performance of the sales job. Today's sales representatives are often armed with laptop computers usually configured with e-mail, fax, and Internet access as well as other features used to maintain virtual offices. These communication tools allow salespeople to stay connected to their customer and coordinate actions required to satisfy their needs.

The sales category has a strong connection with the communication category. Laptops can be equipped with calendaring and other software features used to set up sales appointments, develop presentations and proposals, and assess customer information. Research suggest that sales representatives believe that technology has had a profound effect on the level and quality of information they are able to present to customers in sales calls and in their overall professionalism (Moncrief et. al. 1999).

The third category, relationship, is viewed as a mechanism for both a relationship development and maintenance. Srirojanant and Thirkell (1998) provided a framework for assessing key elements of relationship marketing and the interactive potential of web pages. It was posited and found that sites offering greater levels of interactivity were better equipped to manage and nurture customer relationships in a manner that was more satisfying to customers.

Technology also is a critical element of team selling. Conference calls facilitate the coordination of activities among members of the sales team dispersed in various locations and businesses. It should be noted that team selling often includes alliance partners whose efforts must be integrated with the selling firm's in a cohesive manner.

Lastly, the ability to gather and disseminate information within the sales process is critical for managing accounts and organizational decision making. Sales personnel have indicated that database management tools on their personal computers and laptops were critical for updating customer account information, passing on market information and observations, and obtaining up-to-date intelligence.

Technically, the functionality implicit in information and communication technologies should allows sales professionals to be more productive and effective. Firms that develop a technological platform that supports and drives sales activities are expected to be better positioned to satisfy their customers and maintain relationships with them.

Sales Activities and Technologies

Resource-based theorists have proposed that the competitive position of firms can be enhanced with the use of information and communication technology resources (Grant 1991, Bharadwaj 2000, Valentin 2001). Since investments in ICT resources can be easily replicated across the competitive landscape, firms must decide how to exploit these investments to create distinctive capabilities.

In this regard, an ICT resource-based view of sales activities appears to be a valuable framework for discerning how sales activities can be aligned with technologies to facilitate superior business performance in smaller enterprises. This involves viewing the sales job as a collection of activities focused on enhancing small firm operations, and understanding how technological advancements can be embedded into sales processes in order to build firm competencies.

Holland (2004) noted that the sales function in firms has historically contested the use of company-wide computer systems. In the 1990s, corporations made major investments in CRM applications that were to provide a structured and centralized approach to managing customer information used to drive company performance. Some firms developed their CRM systems on their own, while others hired vendors to develop them. The latter has become popular in this new century as firms focus more on their core competencies and outsource other important tasks. As small firms consider jumping on this bandwagon, especially in the area of sales, it is imperative that they consider issues that facilitate the implementation and use of such systems.

Characteristics of Technology Affecting Small-Firm Sales Effectiveness

Upon evaluating the "unique characteristics" of small firms, Telem (1989) proposed a technology integration framework involving different levels of technology growth. This model defined a process allowing small ventures to gradually incorporate various technological innovations into their business operations over a period of time until a mature technological platform existed and deemed central to internal and external small-firm functioning. A key aspect of the resultant technology-based infrastructure is the greater level of interactivity provided to facilitate increased customer interaction, real-time collaboration, ongoing information exchanges and alternative sales channels. Srirojanant and Thirkell (1998) asserted that the Internet has become a viable means for firms of all sizes to exploit in order to interact more efficiently and effectively with business constituents. Application Service Providers (ASPs) have used it to offer small firms a means to obtain CRM/sales force automation tools for organizational use.

Research has shown that the information and knowledge needed to conduct business is often distributed among many individuals (Rathnam, Mahajan and Whinston 1995). As a result, information required to address customer needs and meet ongoing business requirements must constantly be exchanged among salespeople and other intra- and interfirm personnel. Without mature ICT systems, sales representatives engaged in a high variety of interdependent activities must access data from various manual or computerized systems, and then develop a process for consolidating the data. These types of information silos have often been found to permeate in small-business environments (Igbaria, Zinatelli, Cragg, and Cavaye 1997). Studies have suggested that the development of an integrated technology-based platform can be looked upon as a resource management issue (Duncan 1995; Karimi, Gupta, and Somers 1996). The implication here is that the planning, implementation, and control of all relevant IT resources serves as the foundation for building critical firm capabilities.

The fact that IT-based CRM capabilities are provided to a sales force doesn't guarantee they will be utilized. Davis et. al. (1989) developed the Technology Acceptance Model to examine the acceptance of new information technologies by end users. Driving factors affecting technology acceptance in small firms include beliefs about usefulness, ease of use, and comfort level (Igbaria, Zinatelli, Cragg, and Cavaye 1997). Additionally, when analyzing the factors impacting the utilization of Internet purchasing in small firms, Olson and Boyer (2003) found that the attitude of some purchasers impacted organizational performance.

Based on the above discussion, five factors—resource management, usefulness, ease of use, and comfort level—will be used to conceptualize sales effectiveness and assess its impact on small firm performance. The following section will outline the research methodology.

METHODOLOGY

The 62 salespeople surveyed were attended training seminars conducted by a value-added reseller (VAR) with office throughout the U.S. The VAR provided a distribution list with contact names for about 500 small firms they worked with to develop IT systems containing CRM/sales force automation tools. The primary contact at each firm, usually the business owner or manager, was asked to fill out a short survey for the VAR and asked to provide their salespeople a link to an online survey. Salespeople were asked to complete the survey within a two week period. The composition of responding firms across industrial classifications was: 19% retail, 16% manufacturing, 24% business services, 21% other services, 9% non-profit and 11% other industrial. The average age of participants was 39 and over 80% were college educated.

Mechanisms commonly used to enhance response quality and rates were used. The questionnaire was formulated drawing on the expertise of small-business sales professionals representing seven different product and service industries, a Small Business Development Center officer, VAR sales representatives and a small business consultant. The results of these interviews were especially critical to the development of measures of small-firm performance.

Measures of the four technological acceptance variables were taken from Davis et. al. (1989) and Olson and Boyer (2003). The remaining independent variable, resource management, was measured using a scale developed by Karimi, Gupta, and Somers (1996). Subjective measures of firm performance, the dependent variable, were taken by looking at three items: the level of customer satisfaction compared to last year, level of customer loyalty compared to last year, and improvement in sales rep's morale.

Seven point Likert scales were used for all questionnaire items. Table 1 provides a profile of the scales used for the independent variables in this study.

Table 1: Scale Reliability (sales effectiveness)

Dimension	Number of items	Cronbach Alpha
1) Resource Management	11	0.872
2) Perceived Usefulness	8	0.816
3) Perceived Ease of Use	6	0.793
4) Comfort Level	4	0.723
5) General Attitude	4	0.706

FINDINGS

The intent of this research was to empirically explore the relationship between the level of acceptance of a current technological innovation diffusing in the small firm environment, CRM/sales force automation. Using three measures of small firm performance as dependent variables and five measures of sales effectives as independent variables, a multiple regression analysis was conducted. Table 2 highlights pertinent data pertaining to the independent variables. The significant coefficients associated with each component of sales effectiveness lend support to the convergent validity of the construct.

Three sets of analyses were completed with the sales effectiveness components as independent variables in each case. The three dependent variables were small firm performance measures based on customer satisfaction, customer loyalty and productivity improvements associated with sales job.

Table 2: Dimensions of Sales Effectiveness—Regression Coefficients		
Independent Variables	Coefficients	*p* value
1) Resource Management	0.266	0.032
2) Perceived Usefulness	0.241	0.040
3) Perceived Ease of Use	0.298	0.026
4) Comfort Level	0.219	0.043
5) General Attitude about Technology	0.252	0.033

Table 3 presents the regression results. The findings provide evidence of a significant and positive relationship between all of the sales effectiveness components and customer satisfaction. Resource management was found to be the best predictor of variations in customer satisfaction, followed sequentially by perceived usefulness, comfort level, perceived ease of use and general attitude. In other words, salespeople who view their CRM/sales force automation systems as effective report higher levels of customer satisfaction than the sales reps that do not. Overall, 69 percent of the variation in customer satisfaction is accounted for by sales effectiveness.

The middle column in Table 3 depicts the findings related to sales effectiveness dimensions on customer loyalty. Four of the five sales effectiveness variables demonstrate a significant and positive relationship with customer loyalty. Perceived usefulness had the greatest predicting power, followed by resource management, perceived ease of use and general attitude about technology. Although the association between comfort level and customer loyalty was not significant, the correlation was positive. Thus, with and without this dimension sales effectiveness explained 55 and 49 percent respectively of the variation in customer loyalty. Stated differently, salespeople who view their CRM/sales force automation systems as effective show report higher levels of customer loyalty than the salespersons that do not.

The final regression analysis of the sales effectiveness components on salesperson morale is exhibited in the last column of Table 3. The results provide evidence of a significant and positive relationship between all of the sales effectiveness components and the dependent variable, improved morale of sales reps. The predicting power of the variables from strongest to weakest was as follows—perceived usefulness, perceived ease of use, resource management, general attitude and comfort level. Together, the variables explained 63 percent of the total variation in improved productivity.

DISCUSSION

This study found support for the proposition that the factors used to conceptualize sales effectiveness contributed significantly to the three measures of small firm performance examined. In general, how technology is managed by a firm and accepted by the participants in this study influences various elements of business performance. The technological innovation central to this study was CRM/sales force automation systems.

Table 3: Dimensions of Sales Effectiveness—Regression Analysis
Dependent Variables Beta (p value)

Independent Variables	**Customer Retention**	**Customer Loyalty**	**Improved Morale**
1) Resource Management	0.24 (0.01)	0.23 (0.02)	0.21 (0.03)
2) Perceived Usefulness	0.24 (0.02)	0.24 (0.02)	0.25 (0.02)
3) Perceived Ease of Use	0.21 (0.03)	0.22 (0.03)	0.24 (0.02)
4) Comfort Level	0.22 (0.02)	0.12 (0.30)	0.20 (0.03)
5) General Attitude about Technology	0.20 (0.03)	0.21 (0.04)	0.20 (0.04)
R^2	0.69	0.55	0.63

The perceived usefulness of such systems had the strongest predicting value for two out of the three dependent variables. When talking to several of the research participants in follow-up conversations, it was mentioned that one of the major concerns for salespeople working for small companies encompasses "spreading ourselves to thin." The findings of this research suggests that when technological tools are designed to facilitate productivity improvements, from the perspective of those whom will be using them, that end users are more inclined to use them.

Vendors often prefer to sell small firms "canned packages" because it is less likely that they would be a resource drain on their firms. However, salespeople can only perceive CRM tools to be useful if they are customized to coincide with the specific sales process within each firm. Some of the sales reps interviewed and the owners of the firms employing them expressed concerns that vendors spend more time telling them how they should conduct their business as opposed to addressing how their products could meet any small firm's particular requirements.

Another integral component to sales effectiveness was resource management. Small firms get superior benefits from the utilization of CRM systems when their salespeople believe that management actively supports the use of these systems; and are able to envision how the implementation of these systems is aligned with company goals. This implies that it might be advantageous for small firms to include their sales personnel in the development of their overall strategies. A win-win situation is crafted when salespeople view the implementation of CRM systems as nothing more than a tactical move used to implement a strategy and drive business performance. It is also helpful when small firms make sales representatives part of the process for selecting CRM tools and functionality.

The exploratory nature of this research has paved the way for additional undertakings. First, as the customer is the final arbiter of how firms perform, it would be useful to ascertain if customer and/or management perceptions of performance are the same as their sales representative. Next, how does the sales process differ in marketing a particular product to large versus small businesses? Lastly, how are financial measures of performance impacted by sales effectiveness?

Technological advancements will continue to diffuse through the marketplace and provide small firms and their sales personnel with a myriad of options for business use. Thus the question comes to mind, how do small firms select their selling tools and what role do salespeople play in the process? Do salespeople have to play the role of internal salesperson to make management understand the importance of CRM/sales force automation tools? Do lower levels of sales effectiveness lead to higher turnover rates among sales personnel?

The need for small firms to sustain their competitiveness is evident more today than ever. Customers are more demanding and new sales channels such as the world wide web have increased the intensity of competition. Companies must select selling tools and use them effectively in order to enhance their performance. As the primary link to the customer, salespeople in small firms should play an integral role in the development of strategies and tactics used to enhance performance.

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TO FLIP OR NOT TO FLIP?: USING A FAMILY LIMITED PARTNERSHIP AS A HARVESTING STRATEGY

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ABSTRACT

The purpose of this paper is to focus on the Family Limited Partnership as a potential harvesting strategy. The use of a family limited partnership (FLiP) in succession planning has proliferated in recent years. The popularity of FLiPs can be attributed to the unique benefits they offer to manage and transfer family assets, while minimizing gift and estate tax liabilities through careful planning of intra-family transfers. However, a recent court decision may be of concern to those who use a FLiP to reduce taxes and fail to establish sufficient non-tax business reasons for transferring assets to a FLiP.

INTRODUCTION

It has often been said that it is easier to start a new venture than to close or leave a successful business. One of the most misunderstood aspects of the entrepreneurial adventure is developing and implementing a strategy for harvesting the results generated from successful new ventures. A major reason for this phenomenon is the lack of planning a harvesting strategy at the time we begin a new venture. For example, at the Eleventh Annual Babson College Entrepreneurship Research Conference, Steven Holmberg presented findings from a survey of computer software companies regarding formal planning for harvesting the value created in these businesses. Of the 100 companies responding, only five percent had a formal harvesting plan prepared contemporaneously with the start-up business plan. Fifteen percent had a written strategy for closing or harvesting the value created in their ventures. That leaves 80 percent with no formal harvesting plan for closing their companies (Holmberg, 1991).

Unfortunately, many entrepreneurs begin to think about winding up a business when it is too late: events regarding the business have taken on a life of their own; there is too much debt and not enough cash flow; a competitor or new product has eroded your ability to compete; the owner dies or becomes ill and cannot operate the business any longer; and so forth. Why is this? One response might be that it makes no sense to develop a strategy for selling or closing a business until you have a business to sell or close. And why divert the energy it takes to develop a harvesting strategy away from creating a successful venture when most entrepreneurs know the primary focus must be the development of a market for a product or service and then generate continuing sales from the customer base that was created? Another answer is that we do not want to get involved with accountants and lawyers dealing with complicated valuation and tax issues.

Those interested in becoming successful entrepreneurs have met or read about the successes of some of those who created new ventures – those who started companies and sold or closed them, ending up with millions of dollars – capturing the American dream. What we do not read about or meet are the many more creators of new ventures that have had to sell out or lost their businesses. What separates the two? One answer is the former set of entrepreneurs had a harvesting strategy and the latter did not. Creating a harvesting strategy is a complicated and often a time consuming process. Begin the process in sufficient time to create a plan that, when implemented, will allow one to harvest the rewards of one's labors.

Most persons reading this article are acquainted with the metaphor of the "window of opportunity." If, for example, one misses the "window of opportunity" to sell a company, the opportunity to sell the company again, at the same value, might never happen again. One needs to be prepared to take advantage of the "window of opportunity" in order to enjoy the benefits of harvesting the value from a successful business. In today's world, it has become increasingly more difficult to "be ready" to take advantage of that "window of opportunity." One reason is the expensive and complicated requirements of the Sarbanes-Oxley Act with regard to attaining certain accounting standards before a sale can be consummated. If your company is not actively meeting the requirements of the Sarbanes-Oxley Act, you might not be in a position to sell your company and thus you will miss that "window of opportunity." Again, the objective with regard to succession planning is to put a plan in place and implement it.

The message to those who desire to attain their dream of creating a new venture is to include in that dream the harvesting of the value created from the successful business. Do not miss the "window of opportunity" by waiting until it is too late to sell or close or leave your business to others. Plan ahead. A good harvesting strategy can take three to five years or longer to implement. One must decide how one will harvest the value from a successful business. As an owner, it is important to consider the impact of your succession planning on yourself, your family, employees, the money you will receive, and taxes. There are several alternatives ways of harvesting a business, including but not limited to management buy outs, mergers or acquisitions, going public, liquidation, or licensing. Find a competent attorney and tax professional. But above all, create a plan.

FLIP FUNDAMENTALS

The purpose of this paper is to focus on the Family Limited Partnership as a potential harvesting strategy. The use of a family limited partnership (FLiP) in succession planning has proliferated in recent years. The popularity of FLiPs can be attributed to the unique benefits they offer to manage and transfer family assets, while minimizing gift and estate tax liabilities through careful planning of intra-family transfers. However, a recent court decision may be of concern to those who use a FLiP to reduce taxes and fail to establish sufficient non-tax business reasons for transferring assets to a FLiP.

The most common scenario for use of a FLiP is when parents who have accumulated wealth who want to pass on their estate to their children, yet keep control of the earning assets. This is generally accomplished by having the parents transfer the assets to a limited partnership in exchange for a 99-percent limited partnership interest. To insulate the parents from the claims of the partnership's creditors, management of the partnership is generally vested in a corporation acting as the general partner of the limited partnership. Ownership of the corporation is often vested in both the parents and children by contributions of initial capital in proportion to their desired ownership interest. In the event children do not have sufficient capital to purchase stock in the corporation, stock can be issued in exchange for their unsecured notes to be paid from future corporate profits. Common provisions of the corporate bylaws and/or partnership agreement provide that family members or the FLiP be given first right of refusal on the sale of shares in the corporate general partner or interests in the FLiP. Typically, ownership of the

FLiP is given to the children gradually over the remaining lives of the parents or passes to the children through the parents' estates upon their deaths.

August and Rappoport (2000) identify eight benefits derived from using a FLiP:

1. *Family Succession Planning*. Many families face real problems when going through the probate of the parent's estate. Unplanned succession can lead to fighting and hurt feelings. Thus one of the major benefits for using a FLiP as an estate-planning tool is the avoidance of family problems at the time of death. All parties to the estate are aware of how the succession will take place.

2. *Cash Flow*. If there is an ongoing business and/or earning assets, use of the FLiP may allow the company to continue to operate, and the assets to continue to earn. Neither would have to be sold or dissolved to make estate tax payments, thereby providing the heirs a continuing cash flow. In addition, the FLiP balances the return on all of the assets placed into the FLiP. Each heir would receive their pro-rata share of all the assets in the FLiP, thus avoiding family problems by giving one heir an asset that performed differently than assets given to other heirs.

3. *Providing for Children Not in the Business*. Children may not have an interest in or an aptitude or expertise for running the company and managing the assets. The Board of the corporate general partner, most likely the parents and children representing their proportionate interests, can hire a professionals to run the business and manage the assets. As with any corporation, the manager can be paid a salaried employee or can share in the ownership of the corporation either through purchase or incentive-based compensation. The family can plan shared ownership to ensure that it always maintains a controlling interest in the corporation. Since the family assets are owned by the limited partnership and not the corporate general partnership, shared ownership with a manager can be accomplished without diminuation of family assets.

4. *Simplicity of Transfer and Administration*. If the parents' holdings include real estate, transfers to various heirs require that deeds be prepared and that costs associated with real estate transfers be paid. FLiP interests are

personal property, therefore deeds are not required, and their associated costs are avoided.

5. *Improving Return.* Using a FLiP improves returns on family assets in at least two ways. First, professional managers have the expertise to maximize returns from company operations and invested family assets. Second, the family benefits from higher returns and lower costs associated with being able to leverage an undivided interest as opposed to each smaller individual interest attempting to negotiate returns and costs with less bargaining power.

6. *Better Family Relations*. By establishing a governance succession beforehand, parents avoid the potential problem of disagreement amongst their children during the probate of the estate. All of the children will have an interest in keeping the estate assets operating profitably in order to receive future payments.

7. *Asset Protection.* An important benefit of using a FLiP is the protection of the assets inside the partnership from creditors of any of the partners. Under Section 703 of the Revised Uniform Limited Partnership Act, the creditors of a partner cannot obtain ownership of any of the assets of the partnership, but only receive distributions made to the debtor-partner by the partnership. As a result, the family assets are insulated from claims of creditors of the children.

8. *No Ancillary Probate*. Generally each state in which a decedent owns real estate will require probate to transfer the real estate to its heirs. If parental assets include real estate owned in several states, the cost of multiple ancillary probate proceedings can be prohibitive. Real estate placed in a FLiP is protected from ancillary probate proceedings since what is transferred at death is an interest in the partnership not real estate.

TAX BENEFITS OF USING A FLiP

The tax benefits of a FLiP arise because it is the limited partnership interest that is included in the parent's estate not the underlying property that was transferred to the FLiP. The limited partner interest is normally discounted for lack of marketability and lack of control. The lack of marketability discount is applicable because of the aforementioned right of first refusal provision and because their typically is not a ready market for what is essentially a minority interest in a family business. The lack of control discount is applied because the limited partner has no or only an indirect voice in the management of the FLiP, since management is vested solely in the corporate general partner. Together, discounts range from 30 to 40 percent of the value of the underlying property. If the discount is applied to FLiP interests that are transferred using the annual gift-sharing exclusion, the tax savings can be substantial over a relatively short period of time.

BAD FACTS MAKE BAD LAW

In 1975, Albert Strangi, a self-made millionaire, sold his company, Mangum Manufacturing, in exchange for stock of the Allen Group (*Estate of Albert Strangi,* 115 T.C. 475, 2000, hereinafter *Strangi I*). He subsequently moved, with his second wife, the former Irene Delores Seymour (Mrs. Strangi), to Fort Walton Beach, Florida. Strangi married his first wife, Genevieve Crowley Strangi (Genevieve Strangi), in the late 1930s and had four children with her (the Strangi children). Mrs. Strangi had two children from a previous marriage (the Seymour children).

In 1987, Strangi and Mrs. Strangi executed wills that named the Strangi children and the Seymour children as residual beneficiaries in the event that either Strangi or Mrs. Strangi predeceased the other. At the same time, Mrs. Strangi executed the Irene Delores Strangi Irrevocable Trust (the Trust) and designated Strangi as the executor of her will and trustee of the Trust. Mrs. Strangi's will provided that her personal effects were to be left to Strangi and that life insurance proceeds, employee benefits and any residuary of her estate should be distributed to the Trust. A codicil provided that property she owned in Dallas, Texas, should be distributed to the Jeanne Strangi Brown Trust. The Trust provided for lifetime distributions to Mrs. Strangi. Upon her death, the Trust was to distribute her property in Florida to the Seymour children, $50,000 to her sister and the residuary to Strangi if he survived her.

Following several serious medical problems suffered by Mrs. Strangi, she and Strangi moved to Waco, Texas, where they hired a housekeeper, Sylvia Stone (Stone), who also provided assistance to Mrs. Strangi, Strangi executed a power of attorney, naming son-in-law, Michael J. Gulig (Mr. Gulig), as his attorney in fact. In July, 1990, Strangi executed a new will that named the Strangi children as the sole residual beneficiaries of his estate should Mrs. Strangi predecease him, thus excluding the Seymour children in any residual interest of his estate. Mrs. Strangi died in December, 1990. Her uncontested will was admitted to probate in Texas.

Subsequent to a series of health problems suffered by Strangi in 1993, Mr. Gulig took over Strangi's affairs pursuant to the 1988 power of attorney. In August 1994, Mr. Gulig attended a seminar conducted by Fortress Financial Group, Inc., (Fortress) that outlined the use of family limited partnerships (FLiPs) as a means of (1) reducing income taxes, (2) reducing the reported value of estate property, (3) preserving assets, and (4) facilitating charitable giving. Fortress recommended the contribution of family assets to a FLiP and having a corporate generate partner manage the FLiP. Using copyrighted forms supplied by Fortress, Mr. Gulig created Stranco, a Texas corporation, and SFLP, a Texas limited partnership.

To effect the creation of SFLP, Mr. Gulig drafted transfer documents that assigned almost all of Strangi's holdings, valued at nearly $10 million, to SFLP in exchange for a 99-percent limited interest in SFLP. Approximately 75 percent of the holdings were cash and securities with the remainder constituting specified real estate, accrued interest and dividends, insurance policies, annuities, receivables, partnership interests and Strangi's personal residence. Strangi continued to reside in the residence until his death. The SFLP partnership agreement specified that Stranco had the sole authority to conduct the business affairs of SFLP and allowed SFLP to lend money to various entities, including partners.

Strangi purchased 47 percent of Stranco for $49,350. The Strangi children participated in SFLP through Stranco by executing unsecured notes in the amount of $55,650 to purchase the remaining 53 percent of Stranco. Strangi and the Strangi children made up the initial board of directors of Stranco. Stranco never held formal meetings but by unanimous consent agreements, Rosalie Strangi Gulig (Mrs. Gulig) was selected as president and Mr. Gulig was employed to manage the day-to-day affairs of Stranco. All other corporate actions were by unanimous consent agreements. The shareholders' agreement provided that Strangi and the Strangi children would annually reelect themselves or a nominee as the board of directors and in the event of a vacancy due to death, disability and other valid reasons, the number of directors would be reduced by one (*Estate of Albert Strangi v. Commissioner*, T.C. Memo 2003-145, hereinafter *Strangi II*). On August 18, 1994, the Strangi children donated 100 Stranco shares to McLennan Community College Foundation "in honor of their father." (*Strangi I).* Strangi, who required 24-hour home health care beginning in September 1993, died October 14, 1994.

SFLP engaged in the following activities from its inception and after Strangi's death:

1993-94	Paid for back surgery for Stone, who injured her back sometime during the period of time she was assisting Strangi during his convalescence
1994	Paid $40,000 for funeral and estate administration expenses and related debts of Strangi, including over $19,000 for home health-care services provided to Strangi by Olsten Healthcare
1995-96	Paid more than $65,000 for estate expenses and a specific bequest to Strangi's sister
July 1995	Distributed $3,187,800 to Strangi's estate for State and Federal estate and inheritance taxes
1995 and 1996	Distributed $563,000 to each of the Strangi children, characterized as distributions to Strangi's estate
May 1996	SFLP divided its primary Merrill Lynch account into four separate accounts, one for each of the Strangi children, giving them control over a proportionate share of partnership assets
May 1996	Extended lines of credit to three of the Strangi children, John Strangi, Albert Strangi and Mrs. Gulig, in the amounts of $250,000, $400,000 and $100,000 respectively
January 1997	Increased John Strangi's and Albert Strangi's lines of credit to $350,000 and $600,000, respectively
November 1997	Advanced $2,32 million to Strangi's estate to post bonds with the Internal Revenue Service and State of Texas in connection with a review of Strangi's estate tax return
1998	Made distributions of $102,500 to each of the Strangi children

Distributions on behalf of Strangi or his estate were accompanied by matching distributions to Stranco or adjusting entries on Stranco's books. Certain amounts paid by SFLP were initially recorded as advances to or accounts receivables from partners. In addition, SFLP accrued rent from Strangi for use of the personal residence, included this amount in its 1994 tax return and received the accrued rent in 1997.

On January 16, 1996, Strangi's estate tax return was filed by Mr. Gulig. Strangi's gross estate was valued at $6.8 million, including a $6.6 million valuation of SFLP. The appraisal of the interest in SFLP included a 33 percent discount for lack of marketability and lack of control. The property held by SFLP had increased to over $11 million by the date of Strangi's death. In January 1998, the IRS issued a notice of deficiency for over $2.5 million or, alternatively, over $1.6 million of federal gift taxes due upon the formation of SFLP.

Over the next several years, the IRS and the Strangi estate fought through the federal courts over the amount of estate or gift tax due. The Strangi estate successfully defeated arguments by the IRS that (1) SFLP had no economic substance or business purpose and should be disregarded, (2) gift tax was due from Strangi when SFLP was formed, and (3) partnership restrictions should be disregarded in valuing the property. Finally, in May 2003 (*Strangi II*), the IRS was able to convince the tax court that because Strangi retained an interest in the property transferred to SFLP, the property should be included in his estate at its fair market value. The Fifth Circuit Court of Appeals affirmed the decision of the tax court in July 2005 (

So where did Strangi go wrong? The argument advanced by the IRS in *Strangi II*, is contained in Internal Revenue Code section 2036. Section 2036 provides that a decedent's estate should include the fair market value of property over which the deceased retained possession, enjoyment or the right to income from the property or the right to designate who will receive these benefits. However, if the decedent disposed of the property in a bona fide sale, then it is not included in the estate. The court ruled that the payment of Strangi's expenses by SFLP and his continued use of the personal residence were proof enough that Strangi retained possession of or enjoyed the property transferred to SFLP. The question, then, was whether or not the transfer by Strangi to SFLP was a bona fide sale.

A sale is bona fide if the transaction has a substantial business or other non-tax purpose (*Kimbell v. U.S.* 371 F.3rd 257). The Strangi estate advanced five non-tax reasons for the creation of SFLP:

1. *Deterring potential tort litigation by Stone*. The court rejected this as a convincing non-tax reason because evidence showed that Strangi and Stone were "very close", there was no evidence that Strangi caused the injury to Stone, SFLP paid the expenses for Stone and Stone never threatened any action.

2. *Deterring a potential will contest by the Seymour sisters.* The court noted that although one of the Seymour sisters consulted an attorney, the will was never contested.

3. *Persuading a corporation, named in Strangi's will as executor of his estate, to decline to serve.* The court refused to reject as "clearly erroneous" the tax court's finding that there was no valid business purpose related to exector's fees and other related costs.

4. *Creating a joint investment vehicle for the partners.* The court rejected this argument on the basis of the minimal investments by partners other than Strangi.

5. *Permitting centralized, active management of working interests owned by Strangi.* In rejecting this argument, the court noted that there was very little management at all, that there was no operating business and that the assets transferred to SFLP were largely investment assets that required little if any management.

In light of the decision in *Strangi II*, can a FLiP withstand a challenge by the IRS? Consider the following hypothetical case.

GOOD FACTS MAKE GOOD LAW?

George, born in 1940, started a small manufacturing company in 1965. During the following 40 years the business prospered, generating $50 million in annual sales with a physical plant valued at $15 million. In 1985 George hired Fred, a young MBA graduate, to help him manage the company. Initially Fred worked in the various operating departments of the company, finally successfully heading the sales department in 1993.

George and his wife had three children who had grown up and moved away from home. None of them were interested in running the family business. So, in 1994 George met with his tax attorney and accountant in order to establish the best way to pass on the wealth he had created during his life to his family and, at the same time, determine the best way to continue the business for the employees who had helped build it. The discussion was far ranging, going from traditional trusts to Employee Stock Ownership Plans to FLiPs. Based on the circumstances it was agreed the best route for George and his wife was to create a Family Limited Partnership.

During the next year George began the process of creating a FLiP. He wanted to make sure the FLiP would allow him to control the company until he retired, provided George and his wife a retirement income, and meet the standards established by the Internal Revenue Service. This process turned out to be somewhat complicated and he was glad he had expert professional help.

The first step was to establish the Family Limited Partnership. George wanted to make sure the FLiP would operate smoothly after his death, so he put several restrictions in the partnership agreement such as:

Arbitration to Settle Disputes. When the children signed the partnership agreement they consented to have any disputes between them resolved by arbitration. This section of the partnership agreement included a clause that required payment of all costs by a party who unsuccessfully brought an arbitration action against the other partners.

Right of First Refusal and Buy-Sell Agreement. The partnership agreement included a right of first refusal giving the existing partners the opportunity to purchase shares of ownership being sold by any partner. The partnership agreement also established a buy-out process wherein the other partners or the partnership itself may buy the shares offered for sale by one partner at a certain discount to fair market value.

Asset Protection Clause. George's wife was not sure the marriages of all of their children would last and she wanted to make sure her children kept their share of the estate in the event of divorce even though most courts were reluctant to award a Family Limited Partnership interest to the other spouse. To make sure the ownership of the FLiP stayed "in the family", in the event a court awarded one of the children's partnership interest to a non-family spouse, that event would trigger a buy-out provision requiring the partnership to acquire the partnership interest.

George wanted to make sure the company remained in operation so he placed the shares that he and his wife owned (100%) in the company into a Family Limited Partnership. In addition, George placed the deed for the real estate used by company in its operations (land and buildings in several states). George was the general partner owning 10% and George and his wife, as limited partners, owned the other 90%. In order to dampen potential liabilities as the general partner, George created a Sub-S corporation to be the general partner. The long-term plan included the following provisions:

Appraisal of the value of the assets. The company was appraised at $5 million, after taking into account the age of the building and equipment. Because the shares of the company were now the assets of a Family Limited Partnership the value of the partnership's assets could be "discounted due to lack of marketability." It was concluded the value of the company's shares in the FLiP could be discounted by 40% and were therefore appraised at $3,000,000 at the time the assets were transferred into the FLiP on June 1, 1994.

Management succession. During the first five years after the partnership was established, George agreed to sell to Fred half of his ownership interest in the Sub-S corporation that was the general partner of the FLiP. When George retired or died, Fred would be promoted to manager of the company and, pursuant to a pre-existing agreement, George (if alive) and his wife would retain half of the ownership of the general partner and receive retirement payments until both George and his wife passed away. At that point in time, the other half of the general partner would be sold to the company.

Avoidance of Lack of Valid Business Purpose. By putting into place a management succession, which provided for his employees, George knew the IRS usually considered a FLiP to be created solely for the purpose of reducing or avoiding estate taxes. By making sure the company would continue to operate the IRS could not make the argument the FLiP was set up as a sham transaction.

Distribution of Limited Partnership Interest. Beginning in 1995, George and his wife combined their $11,000 annual gift exclusion and give away their limited partnership ownership interests to the children. During the next 10 years the children received $660,000 in tax-free distributions from their parents.

In 2005 George and his wife were killed in a traffic accident and the remainder of George's succession plan went into effect. Fred became the general manager of the company and had the value of the company appraised in order for the company to purchase the other half of the general partner. The value of the company was appraised at $15 million, a substantial increase from the $5 million value in 1994.

The estate went into probate with the exclusion of the Family Limited Partnership, which owned the company. If the FLiP had not been put into place, the estate would have had to pay estate tax on the $15 million appraised value of the company in 2005. Assuming the estate tax rate to be 50%, the tax would have been $7.5 million. In the event the children did not have the ability to pay such an amount, they would have no choice but to sell the company. Since the FLiP was in place, the only estate tax that was applicable to the company was paying tax on the 5% general partner interest, using the 1994 value of $15,000 (half of $30,000), and the remaining limited partner interest, valued at $2,040,00(0 again using the 1994 valuation). However, there would be no tax due to the $1,500,000 lifetime estate tax exclusion.

1. *Family Succession Planning.* Many families face real problems when going through the probate of the parent's estate. Unplanned succession can lead to fighting and hurt feelings. Thus one of the major benefits for using a FLiP as an estate-planning tool is the avoidance of family problems at the time of death. All parties to the estate are aware of how the succession will take place.

2. *Cash Flow.* Use of the FLiP may allow the company to continue to operate and not have to be sold or dissolved to make estate tax payments, thereby providing the heirs a continuing cash flow. George could have included his other assets in the FLiP. Had he done so, the FLiP would have balanced the return on all of the assets placed into the FLiP. Each heir would receive their pro-rata share of all the assets in the FLiP, thus avoiding family problems by giving one heir an asset that performed differently than assets given to other heirs.

3. *Providing for Children Not in the Business*. In the case of George and his wife, none of the children had any interest in running the company. The succession plan therefore included a professional manager, Fred, who took

over management of the company while the FLiP continued to pay George's children their share of the company's earnings as represented by their ownership of the limited partner interests in the company.

4. *Simplicity of Transfer and Administration*. When George created the Family Limited Partnership he deeded the property on which the company's plant was located into the FLiP. By taking this action, the estate avoided the potential problem of having to deed part of the real property to each of the heirs since transfers of ownership in a FLiP do not require a deed.

5. *Improving Return*. Many FLiPs retain investment advisors to manage the assets that have been placed in the partnership. In the case of George, he hired Fred, a professional manager, and groomed him take over the operations of the company. The benefit of improving the return on the assets of the estate is rather obvious in this instance.

6. *Better Family Relations*. By establishing a governance succession beforehand, George and his wife avoided the potential problem of disagreement amongst their children during the probate of the estate. All of the children had the same interest in keeping the company operating in order to receive future payments.

7. *Asset Protection.* An important benefit of using a FLiP is the protection of the assets inside the partnership from creditors of any of the partners. Under Section 703 of the Revised Uniform Limited Partnership Act, the creditors of a partner cannot obtain ownership of any of the assets of the partnership, but only receive distributions made to the debtor-partner by the partnership.

8. *No Ancillary Probate*. The company operated in several states and George had placed the deeds for the real estate into the FLiP when it was formed. The benefit to the estate is the manner in which most states treat real property versus personal property. Partnerships, including FLiPs, are treated as personal property and all interests in real property accorded the same treatment. Thus, George's estate avoided probate in those state where the company owned real estate.

TO FLiP OR NOT TO FLiP, THAT IS THE QUESTION

This article has covered some of the basics with regard to using a FLiP as part of a business owner's succession planning. Hopefully entrepreneurs will include a harvesting strategy as part of their original business plan. The benefits of using a FLiP can provide the entrepreneur and his or her family with a potentially best alternative to other tactics available in succession planning. Implementing a FLiP requires the entrepreneur to plan in advance and to utilize legal and accounting professionals. And do not forget, the FLiP must include real business purposes, not just be an artifice for avoiding taxes.

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