Volume 11 **ISSN 1087-8955**

THE ENTREPRENEURIAL EXECUTIVE

An official Journal of the
Academy of Entrepreneurship ®

James W. Carland
Editor
Western Carolina University

Academy Information
is published on the Allied Academies web page
www.alliedacademies.org

The Academy of Entrepreneurship® is a non-profit corporation chartered under the laws of North Carolina in the United States. The Academy is an association of scholars and practitioners whose purpose is to advance the knowledge, understanding, and teaching of entrepreneurship throughout the world.

Whitney Press

Printed by Whitney Press, Inc.
PO Box 1064, Cullowhee, NC 28723
www.whitneypress.com

The *Entrepreneurial Executive* is published by the Allied Academies, PO Box 2689, 145 Travis Road, Cullowhee, NC 28723, USA, (828) 293-9151, FAX (828) 293-9407, email info@alliedacademies.org. Those interested in subscribing to the *Journal*, advertising in the *Journal* or otherwise communicating with the *Journal* should contact the Executive Director at that address. Those interested in submitting manuscripts to the *Journal* should check submission guidelines and other pertinent information about the publication process on the web at www.alliedacademies.org.

ENTREPRENEURIAL EXECUTIVE
EDITORIAL BOARD MEMBERS

ENTREPRENEURIAL EXECUTIVE
EDITORIAL BOARD MEMBERS

ENTREPRENEURIAL EXECUTIVE
EDITORIAL BOARD MEMBERS

Volume 11 **2006**

THE ENTREPRENEURIAL EXECUTIVE

CONTENTS

LETTER FROM THE EDITOR

Welcome to the *Entrepreneurial Executive*. We are confident that this volume continues our practice of bringing you interesting, insightful and useful articles by entrepreneurs and scholars.

The *EE* is an official journal of the Academy of Entrepreneurship®, a non-profit association of scholars and practitioners whose purpose is to advance the knowledge, understanding, and teaching of entrepreneurship throughout the world. It is our objective to expand the role of the *EE*, and to broaden its outreach. We are interested in publishing articles of practical interest to entrepreneurs and entrepreneurial scholars, alike. Consequently, we solicit manuscripts from both groups.

The *Entrepreneurial Executive* is funded by the proceeds of membership dues and conference registration fees at Academy of Entrepreneurship® and Allied Academies meetings. We do not receive funding support from any university or agency. We encourage readers to become members of the Academy and to attend conference meetings in the spring and the fall. Upcoming conferences are announced on the Allied Academies home page: www.alliedacademies.org, as well as information about the organization, its affiliates and its journals. In addition, instructions for submitting manuscripts are displayed on the home page.

The manuscripts contained in this issue were double blind reviewed by the Editorial Board members. Our acceptance rate in this issue conforms to our editorial policy of less than 25%.

James W. Carland
Western Carolina University

ARTICLES

CONFRONTING THE BIG BOXES: COMPETITIVE STRATEGIES FOR SMALL BUSINESSES

Don B. Bradley III, University of Central Arkansas
Andrew Spice, Mallory Alexander International Logistics
Michael J. Rubach, University of Central Arkansas

ABSTRACT

The past quarter-century has witnessed the rise of the big box retail format and the subsequent decline of Main Street small businesses. Today's customers are demanding high-quality products at low prices, greater convenience, and a wide assortment of goods. Wal-Mart's competitive advantage lies in its ability to meet these demands. Specifically, Wal-Mart excels in providing low prices, wide assortment of goods, and the convenience of one-stop-shopping. This paper reviews the research on the competitive responses of small retailers to mass merchandisers and discounters. The paper examines the theories surrounding competitive advantage and the strategies available for small businesses to compete against big box retailers. Although prior research has recommended that small businesses can benefit from differentiation strategies,, this paper argues that a hybrid strategy of low cost and differentiation with an emphasis on providing superior customer service may be the most effective competitive weapon against mass merchandisers such as Wal-Mart. A discussion of the success of dollar stores in competing with discounters supports the argument that a hybrid strategy is effective.

INTRODUCTION

Over the last several decades, the explosive growth of large discount chain stores such as Wal-Mart, Target, Home Depot, and Best Buy is transforming the economic and social landscape of America's towns and cities. The so-called "Wal-Mart phenomenon" has had serious repercussions for small businesses that formerly made up a town's economic engine. In many small towns, chain stores continue to threaten the very existence of locally-owned hardware stores, pharmacies, and grocery stores

The threat of competition from mass merchandisers coupled with changing demographics and shifting consumer purchasing patterns are forcing small businesses to reevaluate and alter their business strategies and models (Love & McGee, 1999). Today's consumers are flocking to chains stores because they want value, choices, convenient locations, extended business hours, the convenience of one-stop shopping, a hassle-free environment, and a friendly personal touch in a clean, fun place to shop (Taylor & Archer, 1994). These changes in retailing have increased the options available to the typical consumer at the expense of the small retailer. Although business may never return to "usual," as in the days before mass merchandisers, there are many opportunities for small businesses in today's economy.

This paper reviews the prior research on the strategic responses of small businesses to the "Wal-Mart phenomenon." Much of the research suggests that small businesses follow a differentiation strategy. There is some contrary support for attacking the mass merchandisers and discounters "head on." The paper addresses the research support for each strategy and how small businesses should respond. A discussion of how dollar stores are successfully competing against discount chains demonstrates the effectiveness of hybrid strategies of low cost/differentiation. Suggestions for future research are discussed.

REVIEW OF THE LITERATURE

The impact of Wal-Mart and other discounters has yet to be fully explored. The literature on the Wal-Mart phenomenon has focused on two aspects. First, the negative impact of the mass merchandisers and discounters on local retailers and the local economy (Welles, 1993; Mammarella, 1994; Steinhaurer, 1995; Stone, 1995, McGee, 1996) has and continues to receive considerable attention by researchers and the popular press. This line of research has indicated that the existence of large discounters disrupts the prevailing retailing patterns (Franz & Robb, 1989; Ozment & Martin, 1990; Daniels & Keller, 1991; Arnold, 1998). This research suggests that large format retailers not only increase the overall competitiveness of the local retail marketplace, but they may also exhibit a pull-factor by drawing in consumers from surrounding communities (Peterson & McGee, 2000). The second line of research explores the reactions of small businesses to the entry of mass merchandisers into their markets. This stream examined the strategies and distinctive competencies of small businesses as they reacted to changes in their markets. The focus of this paper is on this latter stream of research.

Wal-Mart has pioneered the expansion of discounters into rural markets, and through a combination of aggressive pricing and innovative inventory-control systems, has become the world's largest retailer. Wal-Mart succeeds as a huge buyer; it negotiates the best wholesale prices while offering customers the lowest prices and making up the differences in volume (Tsao, 2002). Small businesses are faced with the difficulty of competing with Wal-Mart's economies of scale and scope. As a result, many independent shopkeepers when faced with the entry of a mass merchandiser or discounter are forced to adapt quickly or face bankruptcy (Peterson & McGee, 2000).

Taylor and Archer (1994) outlined eight success factors of successful discounters.

1. *Customers want value*. Consumers have created a greater demand for low-cost, high quality products.
2. *Customers love choices*. Today's consumers expect greater choices in their shopping experiences.
3. *Customers love anything new.* Customers appreciate new stores, renovations, and historical renewal projects.
4. *Customers love convenient locations*. As more and more Americans are adopting a busy, fast-paced lifestyle, convenient shopping locations with accessible parking are in high demand.
5. *Customers love long open-for-business hours*. Extended business hours often translate into the customer's mind as customer service. It is common for mass merchandisers to remain open for 11-12 hours every day, and the practice of 24-hour operations are becoming increasingly common.
6. *Customers want the convenience of one-stop shopping*. The fast-paced lifestyles of many Americans place a high importance on time.
7. *Customers don't want hassles*. Most customers do not like to argue, and will walk away before they complain. The most aggravating hassle factors that are common in small businesses, and that the big boxes haves succeeded in alleviating include:

    Waiting. Customers dislike long lines, slow service, too few checkout lines, and poorly trained personnel.

    Poor return policies. Many discounters follow a "no-questions-asked" return policy, while many small businesses have inadequate and uncompromising policies that frustrate customers.

Stockouts on sale items. Customers do not appreciate driving all the way to a store only to find that the sale item is sold out.

8. *Customers want a friendly personal touch in a clean, fun place to shop.* Customers appreciate a personal touch. Here, small businesses have a definite advantage. It is much more common for employees of smaller businesses to remember customers and to possess extensive product knowledge.

Small businesses that focus on improving any of these factors will increase their competitiveness and have a greater chance of survival.

According to Michael Porter (1980, 1985), organizations should pursue one of two generic business level strategies: either low cost leadership or differentiation. A strategy of low cost leadership translates into a firm's attempt to become the low cost producer/provider in a market or industry. For example, all of Wal-Mart's operations are centered on one thing: providing the customer with low prices. Although Wal-Mart shoppers are getting low prices, they give up other factors that are present in many small businesses, such as a high degree of personal attention and store ambience. Cost leaders use economies of scale and cost controls to achieve low prices. This strategy also typically requires a high relative market share and aggressive pricing. A low cost strategy can be usually be achieved with the adoption of competitive behaviors such as inventory control methods, efficient transportation systems, purchasing practices, such as quantity discounts, efficient staffing, use of new technologies, which include point-of-sales technologies and computers, and efficient use of floor space (Cappel, Wright, Wyld, & Miller, 1994; Rubach & McGee, 2002). The strategy of low-cost leadership is followed by mass merchandisers, as well as small discount stores such as Dollar General and Family Dollar which have succeeded in implementing a low cost strategy (Rubach & McGee, 2002).

A strategy of differentiation, on the other hand, is characterized by firms striving to develop a product or service that is unique (Porter, 1980, 1985). Differentiation can be based on a perception of image or exclusivity due to high quality or unique products or superior customer service (Brennan & Lundsten, 2000). The ultimate aim of differentiation is to create brand loyalty and price inelasticity. In many cases, firms that embrace a differentiation strategy tailor their business models toward a specific market segment. These firms often take the form of specialty shops. Ultimately, a firm that embraces a strategy of differentiation seeks to increase value in the minds of its customers through a variety of methods such as the availability of exclusive brands, a high degree of customer service, or the creation of a unique shopping "experience."

If a firm does not have a clearly defined strategy of competing in its external environment, there is nothing to separate it from the competition— Porter calls this being "stuck in the middle" (Porter, 1980). A lack of strategic clarity can be detrimental to an organization's performance (Porter, 1980; Rubach & McGee, 2002). It is essential that an organization (big or small) focus on a strategy and pursue that strategy in a designated target market.

When faced with the threat of competition from a big box retailer, small businesses do have available options. The popular press and many researchers have recommended that small businesses should focus on a strategy of differentiation that is centered on providing superior customer service, carrying merchandise that is hard to find, and ensuring that employees have extensive product knowledge and customer service training. A common argument among some researchers is that small businesses should not even attempt to compete with discounters solely on the basis of low prices. Discounters and mass merchandisers enjoy seemingly impenetrable purchasing economies of scale that impede smaller retailers from adopting a competitive strategy of low cost leadership (Billesbach & Walker, 2003).

The early research of the Wal-Mart phenomenon (1990-2000) generally supported the recommendation that small businesses had to differentiate themselves from the discounters and mass merchandisers. (Taylor & Archer, 1994; Morris & Gerlich, 1995). Of all the strategies available to small businesses, the one identified as most crucial was a commitment to providing superior customer service (Cox & Gresham, 1997). In a nationwide study of over 500 small businesses (firms with less than $20 million in annual sales), Dwyer (1993) found that the most successful businesses had strategies that emphasized the importance of the customer. Morris and Gerlich (1995) in a study of the effect of the openings on Wal-Mart supercenters on grocery store sales in Texas, set forth some recommended differentiation strategies. While the study did not expressly measure the tactics of the small grocers, the authors recommended that small grocers should not be tempted to compete with Wal-Mart on price, but should differentiate their businesses on the basis of service.

TABLE 1				
	STRATEGY	SAMPLE	DISCOUNTER	TACTICS
Taylor & Archer (1994)	Differentiation	Small Businesses	Wal-Mart	Satisfy Customers Value added; choice; novelty; convenience; accessibility; one-stop shopping; no hassles (no waiting, favorable return policies, no stockouts); friendliness
Morris & Gerlich (1995)	Differentiation	Groceries	Wal-Mart	Service, innovation in product offerings
McGee (1996)	Differentiation/ Change	Independent Retailers	Wal-Mart	Pricing and promotions
McGee & Finney (1997)	Differentiation/ Distinctive Competencies	Independent Retailers	Wal-Mart	Product line management focusing on merchandising programs, especially pricing and advertising .
Litz & Stewart (1997)	Differentiate	Small Hardware Stores	Home Depot	Cost reductions; diversification
Peterson & McGee (2000)	Differentiation/ Change	Independent Retailers	Wal-Mart	Customer value, Quality, image, service
Brennan & Lundsten (2000)	Differentiation			Image; exclusivity; uniqueness; quality; superior service; brand loyalty
Rubach & McGee (2002)	Low Cost Leadership Hybrid	Retailers	Wal-Mart	Lower prices; greater convenience; cost controls
Billesbach & Walker (2003)	Differentiation	Small Businesses	Major Discount Chains (Wal-Mart, K-Mart, Target)	Employee selection and training; competitive pricing; selective merchandising; customer focus; store design and image

Small businesses have a unique advantage in the service area due to the fact that many local merchants have the ability to build personal relationships with customers. Moreover, the small size of many businesses allows more attention to be given to each individual customer. As was typical with this stream of research, the authors often provided laundry lists of best practices. For example, Taylor and Archer (1994), based upon their experience with over 1000 small businesses, recommended fifteen ways for small businesses to provide superior customer service:

1) *Find good employees, train them well, and treat them like superstars.* Employees will be more motivated to perform well if they are treated well. Recently Wal-Mart has been accused by some of its own workers for failing to provide adequate health insurance and other benefits. Small businesses will be able to boast superior customer service only if its workers are fairly provided for.
2) *Constantly monitor how you're doing.* One method of ensuring quality of customer service is to hire "mystery shoppers" to visit the business and conduct a customer service audit.
3) *Keep employees informed.* Employees should be well-aware of any sales or promotions.
4) *Find something to do every day that surprises, excites, or delights a customer.* Employees that go out of their way to help a customer will build customer loyalty.
5) *Make customer service everyone's job.*
6) *Be reliable, keep your promises—and keep your word.* "Don't promise what you can't deliver, and deliver more than you promised. In other words: "Underpromise, over deliver.".
7) *Apologize when you make a mistake and explain how you'll make it right.*
8) *Don't hesitate to say "I don't know" but always follow it with the words "but I'll find out."*
9) *Learn your customer's name and use it.*
10) *Say thanks to your employees.*
11) *Say thanks to your customers.*
12) *Be courteous, friendly, and welcoming.* "Make each person feel as if he or she is the most important person on the premises at the time."
13) *Be efficient and value your customer's time.*
14) *Give your employees the authority to solve problems, and teach them how to do it.*

15) *Be accessible.* The business should be equipped to allow the easy entrance of people in wheelchairs. (Taylor & Archer, 1994: 84-88).

Jeffrey McGee's stream of reach in the mid90s began to draw into question the advice of using a purely differentiation strategy. McGee (1996) surveyed 222 small retailers in five Nebraska communities in which a Wal-Mart store had recently opened. He found that 72% of the responding firms were affected by Wal-Mart's arrival, with 53% suffering negative consequences, and 19% actually enjoyed positive results. With regard to those retailers that were negatively affected, 22% experienced a decline of 10% or less in revenue twelve months after the arrival of Wal-Mart in the area. McGee (1996) found that retailers under the threat of a new discounter responded with lower prices and increased promotions. McGee and Rubach noted (1996) that this response may be conditioned on the relative hostility of the competitive environment. In less hostile environments, retailers are more likely to focus on selective markets than by responding with a price-related tactic. Although there were some differences between those who were negatively affected by Wal-Mart's arrival and those who were not, McGee (1996) found that neither group made dramatic adjustments to their competitive strategy, and that many small retailers appeared to be either unwilling or unable to enact a competitive response

McGee and Finney (1997) using 189 surveys of retailers in communities where Wal-Mart had recently opened stores found that firms that had effective merchandising programs were associated with better performance. The regression analysis of merchandising programs, especially those identified with pricing and advertising, were associated with better firm performance. McGee and Finney (1997) cautioned that their findings should not suggest that firms compete with discounters (here, Wal-Mart) on the basis of price. They did suggest that independent retailers know their product lines and that the retailers can use price and promotion selectively to effectively compete against the discounters and mass merchandisers.

Wal-Mart is not the only retailer that is disrupting rural economies. Litz and Stewart, conducted a similar study to determine the impact Home Depot has had on local hardware stores. They collected data from over 300 hardware stores that were competing in markets in which Home Depot had recently entered. The researchers found that nearly 50% of the respondents experienced a decline in both sales and profits due to the existence of Home Depot.

Peterson and McGee (2000) began to focus on distinctive competencies possessed by independent retailers, rather than generic strategies. In their analyses, they found that the performance of small, independent retailers was positively correlated with a high quality service image, an ability to take action, and the ability to control retailing programs related to price. The better performing local retailers were likely emphasize customer value and a quality image through customer service

In studying the business level strategies of independent retailers, Rubach and McGee (2002) found that small merchants following a hybrid strategy of low cost/differentiation were more successful than most other retailers. Those businesses that were the most successful were those that had identified and pursued a distinct market niche. Moreover, successful local merchants offered unique, but fairly priced, merchandise or value-added services that appealed to their target market. Rubach and McGee (2002) assert that the potential for cost savings exists in a rural market.

Using a sample of 58 small businesses located in area where major discount chains conducted operations, Billesbach and Walker (2003) identified the best practices / success factors of those retailers. Employee training (a service orientation) and the right selection of merchandise were identified as success factors. No single tactic was identified as best, but head to head competition on price and merchandise selection was not recommended.

Brennan and Lundsten (2000) studied the appeal of mass merchandisers and discounters in five small towns in Minnesota. While the study did not expressly measure the tactics of the small grocers, the authors recommended differentiation strategies which emphasize assortment and value. The authors noted that small retailers will find it difficult to compete on price, but should differentiate their businesses on the bases of image, quality and service.

Changes in consumer buying patterns have prompted some researchers to argue that a firm’s decision to follow one strategy (either cost leadership or differentiation) is no longer enough to remain competitive. Today’s consumer is becoming increasingly sensitive to price, but is also demanding more value and higher quality products (Rubach & McGee, 2002). Those firms that can provide both high quality and affordable products are capturing the most market share in many industries. For many companies, a hybrid strategy of low cost/differentiation has become increasingly profitable.

THE CASE OF DOLLAR STORES

Contrary to much existing research, Rubach and McGee (2002) found that local retailers following a low cost/differentiation strategy were more successful than those firms following solely a strategy of differentiation or no clearly defined strategy. Their findings are buttressed by the recent success of the so-called "dollar stores" such as Dollar General and Family Dollar. Pitted squarely against the discount behemoth, Wal-Mart, these small dollar stores have succeeded in becoming the fastest-growing retailers in America. Through a strategy of cutthroat pricing, Dollar General and Family General have led the dollar store sector, which earned $16 billion in 2003. The sector added more than 4,000 new stores in the period 2001-2004, an increase of 34% (Berner & Grow, 2004). Moreover, some 36% of customers polled by market research firm Retail Forward frequent these stores monthly, up from 26% in 1997 (Tsao, 2003).

Dollar stores have been successful in undercutting Wal-Mart on two counts: their ability to offer lower prices and offering greater convenience. These are two of Wal-Mart's core competencies that have made up the bedrock upon which the discounter has based its competitive advantage. The sheer size of a typical Wal-Mart Supercenter has actually created inconveniences for customers who must make special trips to the outskirts of town, where most Wal-Mart Supercenters are located. Parking becomes the next inconvenience, as customers must find a parking space and then make the trek across the mammoth parking lot. Dollar stores, on the other hand, are much smaller than a typical Wal-Mart store, and are located in downtown neighborhoods, which are closer to where people live. Parking is usually no problem, and shoppers can make the shopping experience quick and painless. According to David A. Perdue, Dollar General's chief executive: "Wal-Mart competes on price and assortment; we compete on price and convenience" (Berner & Grow, 2004).

The dollar store chains have succeeded in beating Wal-Mart on price not by matching the discounter's famed technology and bargaining power with suppliers, but by offering its customers even less in the way of frills. Dollar stores have ultra-low overheads through an aggressive strategy of cost-cutting. Most dollar stores are located in second-tier strip malls, which save significantly on real estate costs. In addition, dollar stores, which began as liquidators, are adept at scavenging bargain leases from other retailers that go out of business (Berner & Grow, 2004).

Another source of cost savings comes from dollar stores' lack of marketing expenses. Little or no advertising is the norm in the industry—Family Dollar, for example, prints one advertising circular a year. Labor costs are also minimal. Family Dollar and Dollar General only employ about four people per store. Finally, all of the chains are reliant on stock over-runs and closeout merchandise for a portion of sales. This type of merchandising allows dollar stores to charge below-average prices on many branded items that have significantly higher price at Wal-Mart or other mass merchandisers (Berner & Grow, 2004).

Wal-Mart is vulnerable on price. The dollar stores' have succeeded in undercutting Wal-Mart's prices by operating on ultra-low overheads and relying on product overruns for a portion of sales. In so doing, dollar stores offer a tangible model for locally-owned small businesses seeking to thrive in the midst of Wal-Mart's shadow. However, small businesses must not stop here. Some degree of differentiation is needed for small businesses to distinguish themselves from simply becoming dollar stores. In addition to low prices, customers are demanding value. One way small businesses can differentiate themselves and increase value in the minds of customers is becoming specialty stores that offer premium, name-brand goods at competitive prices. For example, take the experience of Robert and John Reny, owners of a 14-store outdoor apparel chain in Maine.

> "We were scared," admits Robert Reny, 50, referring to the time Wal-Mart first ventured into Maine. Along with his brother, John, 52, Robert runs Reny's, a 450-employee chain of 14 department stores founded by their father, Robert Sr., 78, in 1949. From their headquarters in Newcastle, the siblings together studied Wal-Mart's positioning and tactics and shopped its stores, looking for ways to differentiate themselves from the retailing giant…. At the time—about ten years ago—the Renys concluded that Wal-Mart had a lock on "hard" goods, but that it was vulnerable in "soft" goods (clothing and shoes), which now account for roughly half of the Reny's chain's $45 million in annual sales. "In clothing Wal-Mart sells whatever is inexpensive," notes John Reny. By upgrading Reny's clothing mix, the brothers aimed to maneuver around the giant retailer….Their two-pronged strategy relied heavily on their company's nimbleness. First, they emphasized higher-quality brands, such as Columbia, Timberland, and Woolrich, at still-reasonable prices. While once a top seller of Dickies clothing, Reny's has now become one of Maine's largest carriers of Carhartt workwear, a higher-end brand—and one not carried by Wal-Mart. Still, they remained sensitive to price. "We try to be a little bit below the market and accept a little less margin," John notes.
>
> At the same time, the brothers gobbled up small lots of closeouts, irregulars, seconds, and production overruns from those same better-quality, name-brand apparel makers and aggressively marked down the prices. They knew that Wal-Mart, dealing with much larger volumes and uniform merchandise, simply could not engage in such guerrilla retailing….Last year Reny's scooped up and sold 30,000 pairs of fleece-lined jeans and 5,000 children's winter jackets, selling each item at $20.

> Bought directly from the factory, the items came via production overruns from a competing retailer that was selling the jeans at $40 and the jackets at $60.
>
> The strategy has paid off. The first year after Wal-Mart's arrival, Reny's annual growth dropped from 8% to zero. But it edged up to 3% the next year, and since then it has doubled to 6%. Despite Wal-Mart, Reny's has remained profitable. It recently completed a 90,000-square-foot office, warehouse, and distribution complex to better compete with—who else?—Wal-Mart. (Welles, 2004)

The Reny's strategy provides an exceptional example of a small business engaging in direct competition with Wal-Mart on the basis of low prices and differentiation. In adopting a competitive strategy, the first step for a small business is to analyze its strengths and weaknesses to identify any niche market left untouched by the big boxes. Once this niche has been identified, the small businesses should determine a competitive strategy among low cost leadership, differentiation, or a hybrid strategy of low cost/differentiation. For many small businesses, a strategy of differentiation is appealing and the most feasible. Following a strategy of differentiation allows small merchants to avoid competing on the basis of price, but rather focus on increasing value for the customer through exceptional customer service, providing merchandise that is hard to find elsewhere, and creating a memorable shopping experience. Although differentiation does provide a means of competing with Wal-Mart and other discounters, a more effective competitive strategy may be a hybrid form of low cost/differentiation (Rubach & McGee, 2002).

In order to implement a strategy of low cost/differentiation, small businesses should focus on the following: pricing, cost controls, merchandise mix, creating a unique shopping experience, and providing superior customer service. Small businesses can typically achieve cost advantages through the adoption of a number of activities including inventory controls, efficient transportation systems, efficient purchasing practices, efficient store staffing, and the use of new technologies including point-of-sales technologies and computers (Rubach & McGee, 2002). By implementing cost-controls, the savings can be passed on to customers in the form of lower prices.

Small businesses can follow the example of the dollar stores in order to reduce costs. Family-run businesses can save money on labor costs by hiring within the family. Moreover, like the dollar stores, property costs are also favorable to smaller businesses. Another source of cost savings can arise from the practice of salvaging merchandise from closeouts. Small businesses can follow the dollar stores' lead in aggressively scanning the area for liquidations and other sources of inexpensive, high-quality merchandise. Another source of cost savings for small retailers can be found in the creation of a network (or alliance) of stores. For example, a network of small stores located near each other can consolidate orders in order to reap the cost savings associated with full-truckload deliveries rather than incur the higher cost of partial-truckload deliveries (Metters, Ketzenberg & Gillen, 2000).

Although most small businesses cannot compete with Wal-Mart on the basis of assortment of goods, many can compete with Wal-Mart by becoming specialty stores that carry unique items that are hard to find elsewhere. Retailers are finding that customers value broad choices of product categories rather than an endless line of products within a category. Metters, Ketzenberg & Gillen (2000) found that more than half of the dry-goods items in grocery stores sell less than one unit per week, and that most grocers have too much variety. Once a threshold of variety is reached, total category sales barely budge by including more (Metters, Ketzenberg & Gillen, 2000). This explains why dollar stores such as Dollar General can offer many categories but just one or two brands within each in order to offset the advantages of size enjoyed by Wal-Mart and others (Metters, Ketzenberg & Gillen, 2000).

The increasing "Wal-Martization" of our culture has left many shoppers longing for the days when shopping meant strolling in and out of boutiques and specialty stores on a tree-lined Main Street. A huge part of Wal-Mart's low cost strategy entails a no-frills approach in which little attention is paid to store ambience and customer service is virtually non-existent. The arrival of a Wal-Mart to a community is an opportunity to provide a unique shopping experience that is lacking in the business models of many mass merchandisers.

It is important to note that the quality of customer service a small business can deliver is directly related to the quality of its employees. Employees with extensive product knowledge are better-equipped to completely satisfy customers and provide a value-added shopping experience. It is essential that small businesses spend adequate time and resources training employees to provide superior customer service.

FUTURE RESEARCH

The impact of Wal-Mart and other discounters has yet to be fully examined. Present research that suggests that the existence of large discounters disrupts the prevailing retailing patterns (Franz & Robb, 1989; Ozment & Martin, 1990; Daniels & Keller, 1991). This research suggests that large format retailers not only increase the overall competitiveness of the local retail marketplace, but they may also exhibit a pull-factor by drawing in consumers from surrounding communities (Peterson & McGee, 2000).

Future research should continue to examine the strategic responses of small businesses to the presence of discounters and mass merchandisers. The evidence as to which strategic responses are most effective is conflicting. In what industries would a low cost or hybrid strategy be most appropriate? Where are differentiation strategies most appropriate? Where are the Wal-Marts and other discounters most vulnerable?. Wal-Mart has always been weak in its soft goods, but will this continue? Where else should small retailers have an advantage? There are still numerous opportunities to fine tune the contexts of strategies and tactics that small retailers should employ to succeed against the large discounters.

CONCLUSION

It is essential that small businesses do not shirk from the threat of competition from mass merchandisers and continue with the status quo. Small retailers must assess their strengths and weaknesses and commit to a competitive strategy that focuses on firm-specific competencies (McGee, 1996; McGee & Love, 1999). So far, Wal-Mart and others have pursued a strategy based on low cost leadership. Many in the popular press argue that the only recourse left to small businesses is to differentiate themselves by focusing on strengths such as customer service and superior product knowledge. However, the phenomenal success of dollar stores offers evidence that smaller retailers can compete with Wal-Mart on price. Pitted squarely against Wal-Mart, these small dollar stores have succeeded in becoming the fastest-growing retailers in America. Dollar stores have been successful in undercutting Wal-Mart on two counts: their ability to offer lower prices and offering greater convenience. These are two of Wal-Mart's core competencies that have made up the bedrock upon which the discounter has based its competitive advantage.

Although differentiation does provide a means of competing with Wal-Mart and other discounters, the most effective competitive strategy (if possible) may be a hybrid form of low cost/differentiation (Rubach & McGee, 2002). If small businesses pursue cost- saving measures such as buying seconds, product overruns, and closeouts of name-brand products, they may be able to compete with the likes of Wal-Mart. In this scenario, small businesses can provide value-added differentiation to customers in the form of higher-quality goods at competitive prices.

The past quarter-century has witnessed the rise of the big box retail format and the subsequent decline of Main Street small businesses. As Wal-Mart, Target, Home Depot, and other mass merchandisers continue to grow exponentially, small businesses must adapt to a fast-changing retail environment. Today's customers are demanding high-quality products at low prices, greater convenience, and a wide assortment of goods. Wal-Mart's competitive advantage lies in its ability to meet these demands. Specifically, Wal-Mart excels in providing low prices, wide assortment of goods, and the convenience of one-stop-shopping.

As small businesses are coming to grips with the demands of their external environment, many opportunities exist for local merchants to excel amidst the big boxes. It is very difficult for a big box retailer to compete with a local business with regard to the relationships small businesses have their customers. This is the hidden strength that is available to many small businesses, yet many continue to neglect and even ignore. Wally Bock, a retail consultant based in Wilmington, N.C. commented for Fortune magazine: "In most of the communities where you get weeping and wailing about the coming of a Home Depot, you'll find stores that were habitually giving crappy customer service" (Hyatt, 2004). This is a poignant observation that warrants further reflection. Perhaps the arrival of the big boxes has unleashed the competitive forces that have created new opportunities for small businesses to excel, yet punished those local businesses that have refused to adapt to changing consumer buying patterns. In any event, small businesses have the potential to capitalize on the current demand for fulfilling shopping experiences. As more and more customers tire of the "Supercenter experience," perhaps Wal-Mart will inadvertently find itself as being the impetus for reinvigorating small businesses on Main Street.

REFERENCES

Arnold, S.J. (1998). The effects of large formal retailers on smaller communities: A stakeholder analysis. Presented to International Conference on Recent Advances in Retailing and Services Science. Bevino, Italy.

Berner, R. & B. Grow (2004) Out-discounting the discounter. *Business Wee,* May 10.

Billesbach, T. J. & J. Walker (2003). Stalking Goliath: What successful small businesses are doing against major discount chains. *Journal of Business and Entrepreneurship*, *15*(2), 1-17.

Brennan, D.P. & L. Lundsten (2000). Impacts of large discount stores on small U.S. towns: Reasons for shopping and retailer strategies. *International Journal of Retail and Distribution Management, 28*(4/5), 155-161.

Cappel, S.D., P. Wright, D.C. Wyld & J.H. Miller, Jr. (1994). Evaluating strategic effectiveness in the retail sector: A conceptual approach. *Journal of Business Research, 31*, 209-212.

Cox, M. Z., & A. B. Gresham (2000). The role of customer service in small business strategic planning. Retrieved March 7, 2006 from MACROBUTTON HtmlResAnchor http://www.usasbe.org/conferences/1997/Proceedings/papers/p209cox.pdf.

Daniels, T. & J. Keller (1991). What do you do when Wal-Mart comes to town. *Small Towns, 22*: 14-18.

Dwyer, J, III. (1993). Training, use of technology also crucial, study finds. *St. Louis Business Journal*, 13, 36.

Franz, L. & E. Robb (1989). Effects of Wal-Mart on the economic environment of rural communities. Unpublished paper, University of Missouri, Columbia, MO.

Hyatt, J. (2004). Beat the beast: Here's how five small retailers are competing against firms many times their size. *Fortune*: September 1.

Litz, R. & A. Stewart (1997). Lilliputian strategies: Small business responses to big business entry", Unpublished paper, University of Manitoba, Winnipeg.

Love, L.G. & J. McGee (1999). *Distinctive competencies and competitive advantage: A study of small independent retailers. Proceedings from the 1999 USASBE/SBIDA Annual National Conference: Sailing the Entrepreneurial Wave into the 21st Century, San Diego, California.* Retrieved March 7, 2006 from http://www.usasbe.org/knowledge/proceedings/1999/love.pdf

Mammarella, J. (1994). Tarnishing an image: Wal-Mart gets hit by media, consumers, and Competitors. *Discount Store News, 33* (23),109-11.

McGee, J.E. (1996). When Wal-Mart comes to town: A look at how local merchants respond to the retailing giant's arrival. *Journal of Business and Entrepreneurship, 8*(1), 43-52.

McGee, J.E.& B. J. Finney (1997). Competing against retailing giants: A look at the importance of distinctive marketing competencies. *Journal of Business and Entrepreneurship, 9*(1), 59-70.

McGee, J.E. & M. J. Rubach (1996). Responding to increased environmental hostility: A study of the competitive behavior of small retailers. *Journal of Applied Business Research, 13*(1), *8*3-94.

Metters, R., M. Ketzenberg & G. Gillen (2000). Welcome back, Mom and Pop: Big retailers are starting to think small again. *Harvard Business Review,* 78(3).

Morris, T. J. & R. N. Gerlich (1995). Effect of Wal-Mart supercenters on local market food retailing: Survival strategies for the small grocer. *Journal of Business and Entrepreneurship, 7*(1), 31-44.

Ozment, J. & G. Martin (1990). Changes in the competitive environment of rural retail trade Areas. *Journal of Business Research, 21*, 277-87.

Peterson, M. & J. McGee (2000). Survivors of "W-day": An assessment of the impact of Wal-Mart's invasion of small town retailing communities. *International Journal of Retail & Distribution Management, 28*(4/5), 170-180.

Porter, M.E. (1980). *Competitive strategy: Techniques for analyzing industries and competitors*. New York: The Free Press.

Porter, M.E. (1985*). Competitive advantage: Creating and sustaining superior performance*. New York: The Free Press.

Rubach, M. J. & J. McGee (2002). The competitive behaviors of small retailers: Examining the strategies of local merchants in rural America. *Journal of Small Business Strategy, 12*(2), 1-18.

Steinhaurer, J. (1995). Putting the squeeze on the small retailer: Wal-Mart and the 'category killers' take a toll on smaller merchants. *The New York Times*, November 14, C1.

Stone, K. (1995). *Competing with the retail giants: How to survive in the new retail landscape.* New York: John Wiley & Sons.

Taylor, D. & J. Archer (1994). Up against the Wal-Marts: How your business can prosper in the shadow of the retail giants, New York: Amacom..

Tsao, A. (2003). Rising value for dollar stores. *Business Week.* , July 7

Tsao, A. (2002,). Will Wal-Mart take over the world? *Business Week.* November 27.

Welles, E. (2004,). Beat the beast: Going soft. *Fortune.* September.

Welles, E. (1993). When Wal-Mart comes to town. *Inc,* July: 76-88.

THE NEW PHYSICIAN ENTREPRENEUR – FRIEND OR FOE?

Sam D. Cappel, Southeastern Louisiana University
Avi Waiker, Southeastern Louisiana University
Jack E. Tucci, Mississippi State University, Meridian

ABSTRACT

The Physician Entrepreneur - a double edged sword? Is the new physician entrepreneur good for healthcare in the United States or simply another force contributing to the escalating costs of our healthcare system? Regardless of opinions, today's entrepreneurial physicians are steadily becoming a rival to established healthcare providers. Physician owned healthcare services and physician owned specialty hospitals are increasingly capturing a large portion of healthcare dollars, especially in the high profit areas. Depending upon the perspective taken, physician entrepreneurs can be seen as both friend and foe. This study examines some of the positive and negative impacts of the new physician entrepreneur, and examines the role of the physician entrepreneur in shaping healthcare delivery systems of the future.

INTRODUCTION

While physicians have a long history as entrepreneurs, recently the number of physicians participating in entrepreneurial ventures has been growing at an unprecedented rate. The principal factors contributing to this growth among physician entrepreneurs appears to be downward pressures on physician incomes resulting from increased expenses associated with the operation of medical practices, advances in technology resulting in the practice of "scientific medicine", and pressures from third-party payers to reduce payments for medical services The first consideration is increasing costs associated with operating a medical practice.

Physician's practice incomes are eroding today due to lower reimbursements, higher costs for malpractice insurance, administrative burdens, delayed payments for services and complex reimbursement procedures from insurers that require increased professional and clerical man hours, and frequently delay reimbursements (Kalogredis, 2004). One specific example of reimbursement pressure on physician incomes is an initial reimbursement reduction of 4.3% for Medicare Part B charges in 2006, which under current law will continue over a six year period, during which reimbursement reductions for Medicare Part B charges will total 26% (Sloan, 2005). Compounding the pressure of reduced reimbursement is the expectation that physicians will become more efficient as they see more patients in less time - due to population increases combined with a physician shortage. Adding to incomes pressures for physicians created by increases in practice costs are income reductions tied to a shift to more outpatient procedures and reduced length of stay for inpatient procedures. Much of this is a result of scientific and technological advances in medicine.

Scientific and technological advances in the practice of medicine have virtually eliminated the need for “exploratory surgery”. New medical diagnostic equipment, tests, and advances in medical and surgical equipment and processes have resulted in many procedures previously requiring lengthy hospital stays, being performed on an outpatient basis. Scientific and technological advances have also led to shorter lengths of stay for patients requiring in-patient hospital services. While scientific medicine has vastly improved the quality of care, it has also contributed to downward pressures on physician incomes. In addition to income pressures resulting from the increased utilization of science and technology in the practice of medicine, third party payers have also contributed to pressures on physician income levels (Broxterman, 2005).

As healthcare competition heats up along with escalating costs, hospitals, health systems, and physicians are under more pressure than ever to accept risk in the form of various capitation agreements. Under these plans primary healthcare providers are paid a fixed fee based on the number of plan members under their care, or by diagnosis, rather than on the basis of services rendered. According to Johnson and Egger (2000) the major failure of capitation programs to reduce the costs associated with healthcare delivery has been a failure to put physician specialists at risk in the same way that hospitals and primary care physicians are put at risk. New capitation agreements are designed to reimburse specialists based on the number or percentage of plan members under their care, or by diagnosis, rather than basing reimbursement on the number of procedures performed by the specialist as has been common practice for quite some time. This system re-designed is intended to encourage specialists to practice less costly (less profitable) medicine. Given that practice costs are increasing, technology has reduced length of stay, and payers are adopting more comprehensive capitation systems – physicians are seeking ways to protect their income levels.

In order to alleviate income pressures resulting from advances in the application of "scientific medicine" and pressures from third party payers the primary areas of physician investment have been freestanding surgical centers, specialty hospitals and diagnostic centers. In response to this movement, many universities are now offering MD-MBA programs, preparing entrepreneurial physicians to seize new business opportunities. While this may create new opportunities for some, does it also contribute to escalating costs of healthcare delivery, as more physicians are now involved in many new and evolving business opportunities?

CONCERNS

There are many concerns regarding physician investments in health care related services and facilities. A 1992 study in Florida found that at least 40 percent of physicians in that state who were involved in direct patient care, had investments in a health care agency to which they might refer patients. (Mitchell & Scott, 1992). Areas of physician and physician group investments include both diagnostic and therapeutic services often related to the primary practice of the physician or physicians. Specific diagnostic areas where physician investments are common include freestanding laboratories, diagnostic imaging centers (CT scanners, MRI units, ultrasound units and radiology centers) mobile heart catheterization laboratories, and endoscopy centers. Physicians also frequently invest in therapeutic services such as ambulatory surgery centers, minor emergency rooms, dialysis centers, alcohol and drug abuse treatment centers, physical therapy and rehabilitation services, prenatal nutritional centers and radiation therapy centers. Other investments which are common among physicians include home health agencies, durable medical equipment suppliers, outpatient infusion therapy services, and nursing homes (Anonymous, 2004).

The current healthcare system in the United States funds much un-compensated and charity care through a process referred to as cost shifting. Under this system payments received for medical services from insured and private pay patients also cover many of the expenses associated with the delivery of uncompensated and under-compensated care. Thus, by increasing the number of healthy patients with adequate health care coverage and minimizing the number of very sick and indigent patients a medical facility can substantially increase operating profits.

One concern, especially tied to investments by physicians in freestanding outpatient surgical centers and specialty hospitals is the erosion of community based full service hospitals ability to provide charity care. The Texas Healthcare Association's "Report on Limited Service Providers" illustrates the disparity in services provided by full service community hospitals and limited service health care centers. This study found that limited service doctor-owned businesses selectively admit healthier and better reimbursed patients – a process commonly referred to as "cherry picking". Patients who are less healthy and in addition to the primary diagnosis associated with admission present with co-morbidity factors such as coronary problems, morbid obesity, respiratory problems, and diabetes are more likely to be admitted to full-service community based facilities. Under the current system which often involves capitation, a single fixed rate often reimbursed by primary diagnosis, so it more profitable for healthcare facilities to avoid admitting patients who are "high risk". The primary care of these patients is more costly to deliver and the potential liability risk is greater for less healthy patients. Thus "cherry picking" by admitting physicians could increase profits for limited service facilities at the expense of full service community hospitals. In addition to shifting profits to physician owned specialty facilities by patient selection, the offering of limited or no emergency room services also may increase the profitability of specialty facilities at the expense of full service community based hospitals..

Because the emergency room provides a gateway to health care for the indigent, much of the uncompensated in-patient care delivered by full service community hospitals is originated by emergency room admissions. A study conducted by the American Health Standards Group found that limited service healthcare centers deliver significantly less emergency care and access to the emergency department by offering a limited range of emergency services, or in some cases no emergency department. Full-service hospitals within the American Health Standards Group study had an average of 14,760 emergency room visits per year or 40.4 visits per day, compared to an average 480 emergency room visits per year or 1.3 visits per day for physician-owned limited service hospitals that offer some level of emergency services (Speak Out on Doctor Owned Services,1995).

While physician investments in freestanding surgical centers, specialty hospitals, diagnostic and therapeutic services are understandable attempts to protect and increase income levels among physicians, these entrepreneurial practices also raise numbers of questions. For example, a study by the American Health Standards

Group (Speak Out on Doctor Owned Services,1995) determined that there was an increase in orders for services of over 40% when the physician entrepreneur held a financial stake in the service being administered. The question here is whether tests are ordered more frequently by physicians with personal financial interest in the facility providing these services because of financial interests, or is a higher level of care being administered because tests in these facilities are more easily scheduled, feedback is received more rapidly, or because patient inconvenience is minimized? Regardless of the motivation of physician entrepreneurs, the question remains as to the appropriate response by traditional providers.

RESPONSE TO THE PHYSICIAN ENTREPRENEUR

Traditional healthcare providers are using both cooperative and competitive strategies in response to entrepreneurial physicians. Hospital cooperative VHA recently counseled its members to "build barriers" to restrict physician entrepreneurs who compete with them. These barriers can take many forms which include, threats of revoking the admitting privileges of physician investors, lobbying for tighter state control of permits for construction of new medical facilities, convincing insurers that competitive pressures will require higher reimbursement rates to offset volume declines, support of bills that tax facilities providing little charity care to provide additional funds for providers of charity care in the community, and initiating large numbers of lawsuits against those who desire to construct new facilities, are just a few examples of "barrier building"(Anonymous,2004).

Cooperative strategies are emerging especially with regard to hospital / physician joint-ventures. Typically these joint ventures involve procedures that generate a technical fee, or facility use fee from both public and private payers. Ambulatory surgery centers, endoscopy suites and imaging centers are common examples of services where hospitals joint venture with physicians. Hospitals participating in these joint ventures realize that hospital revenues will be reduced, but tend to participate based on the rationale that "half is better than none"-assuming that physicians could move ahead alone or with other partners if the hospital is unwilling to participate (Lifton & Bryant, 2006).

DISCUSSION

There is little argument that the increasing cost of healthcare is a major national problem. Under existing payment structures, much of the costs associated with providing care for the uninsured and indigent are shifted to existing payers. As costs of care and the number of uninsured grow, health insurance costs rise. As health insurance costs rise, fewer businesses can afford to provide medical coverage to employees, fewer employees are able to afford their share of insurance premiums, and fewer of the self employed are able to afford health insurance coverage. The existing structure, which transfers costs for treating the indigent and uninsured to private payers, is no longer working. Cost shifting now acts to reduce the number of payers, provide financial incentives to care providers that target profitable patient populations, and increase the total number of uninsured. Rather than focusing on retaining a system that is failing, perhaps developing a new model is the answer. Can entrepreneurship in medicine provide the foundation for a more successful system?

Perhaps, rather than trying to control the success of the new physician entrepreneur, through additional taxes, legislation to limit their growth, and building barriers to restrict their success, efforts should be made to partner with them for mutual benefit. Providing financial incentives to new physician entrepreneurs may serve to enlist much needed intellectual capital in the quest to design a system that delivers high quality and affordable health care to the population of the United States. In developing solutions for a failing healthcare system much research will be required.

Areas for continuing research should include the examination of practice strategies employed by successful physician entrepreneurs and an assessment of opportunities to transfer these skills to other healthcare providers. Another area for future research is the evaluation of current governmental regulations and controls, to determine which regulations and controls support and which hinder efforts to provide high quality / high value healthcare to our population. It is suggested that research and cooperative efforts are central to the development of a healthcare system capable of providing for the needs of all our citizens now and in the future.

CONCLUSION

The emergence of the physician entrepreneur should not really call the question of friend or foe, as has been the case in most of the academic, professional, and healthcare industry literature. Research demonstrates that physician owned facilities tend to be well run facilities with short lengths of stay and good patient outcomes. Having pressured physicians to reduce patient lengths of stay, integrate more technology in the practice of medicine, accept capitation of payments, while facing increasing costs associated with operating their practices; should it be surprising when physicians seek ways to protect and increase their incomes? The economy in the United States is based on the philosophy that open competition and free market forces result in the delivery of higher quality / higher value products and services to consumers.

New physician entrepreneurs are challenging the established health care delivery system in this country. There are basically two alternatives available which are; enlist the aid of entrepreneurial physicians in designing a more effective and efficient heath care system, or seek to protect the current system that is currently in crisis. Regardless of the alternative chosen, the new entrepreneurial physicians will pay a pivotal role in shaping the health care delivery of the future in this country. The likelihood of significant improvement in the current health care delivery system may well depend on our view of the new entrepreneurial physicians as friends or foes.

REFERENCES

Anonymous (2004). VHA: keep doc investors at bay. *Modern Healthcare*, 34(10):10.

Broxterman, M.P. (2005). Understand the top 10 reasons doctors quit jobs. *Health Care Strategic Management*, 23(10), 9-10.

Johnson,D.E. & Egger E. (Editors) (2000). Providers may not like it, but various forms of capitation will increase for hospitals, physicians. *Health Care Strategic Management*, 12(special issue - future trends), 22-23.

Kalogredis, V.J. (2004). Should you consider concierge medicine? *Physician's News Digest,* February 2004, Retrieved August 26, 2005, from http://www.physiciansnews.com/business/204.kalogredis.html

Lifton, J. & Bryant, L.E. (2006). Establishing principles for hospital-physician joint ventures. *Trustee*, 59(2), 29-30**.**

Mitchell,J.M. & Scott, E. (1992). Physician ownership of physical therapy services: Effects on charges, utilization, profits, and service characteristics. *Journal of the American Medical Association*, 268(15):2055-2059.

Report on Limited Service Providers. (n.d.) Retreived April 15, 2005, from http://www.thaonline.org

Sloane, T. (2005). A reimbursement conundrum; cutting doc's Medicare pay would punish everyone for the excesses of some. *Modern Healthcare,* 35(15), 30.

Speak Out On Doctor Owned Services. (n.d.) Retrieved December 20,2005, from http://www.medicareadvocacy.org

Weintraub,A. (2006, February 20). Should doctors own hospitals? *Business Week*, 63-64.

Zeintek, D.M. (2003). Physician entrepreneurs, self-referral, and conflict of interest: an overview. Health Education Forum, 15(2) 111-133.

STATE OF THE ENTREPRENEURIAL BLOGOSPHERE

Robert J. Lahm, Jr., Middle Tennessee State University

ABSTRACT

Existing scholarly research on blogging is limited, despite the widespread and rapidly growing use of weblogs in actual practice among small businesses and the rise of a new business sector comprised of professional entrepreneurial bloggers. One publisher's brand new "flagship" entrepreneurial and small business academic textbook used in college and university entrepreneurship courses (copyright 2007) fails to index either the term "blog" or "weblog." Several other leading textbooks also fail to index the aforementioned terms. There is a paucity of research expressed in scholarly journals in general, with virtually none published in entrepreneurship oriented journals. It is presumed that the lack of coverage within leading entrepreneurship textbooks is a reflection of scant research in the literature.

Nevertheless, the blogging phenomenon is now so large that it has become known as the "blogosphere." The popular press has documented blogging as what could be described as nothing less than a paradigm shift. Blogging is having a profound impact in the business community, with implications for practice on several fronts. This paper is necessarily exploratory in nature, and presents an overview of blogging and its impact within the business community, with an emphasis on possible implications for future entrepreneurship teaching, research, and practice.

INTRODUCTION

The term "blog" is short for Web log, or its shortened form, "weblog" (Blog, 2006). Early blogs were primarily used as online diaries (i.e., personal logs or journals). However, blogging has evolved and has metamorphosed well beyond this original usage. From a technological vantage point, blogs are related to content management systems (CMS). Content management systems serve as a container, in effect, and allow for the entry, storage, archiving, retrieval, and reporting of data. Relative to weblogs, the reporting is ordinarily in the form information that is displayed on an Internet user's computer screen. As such, content management systems are able to capture and present for either private (through password protected access to certain information, for instance) or public view, the expressed knowledge and experiences of individuals or organizations, or whatever other content is placed within a given system.

Most present day blogs are "dominated by text and photos" (Shapiro, 2003), which are perhaps embellished with graphical images such as photos or illustrations within blog entries (also known as posts) and in headers, navigational sidebars, or advertising material that is displayed adjacent to editorial content. On the other hand, photo blogs, audio blogs--also associated with the term "podcasting" (Podcasting, 2006)--and video blogs are emerging as processor speeds, storage capacities, and bandwidth continue to increase and enjoy greater dispersion among Internet users. (For examples, see: Photoblogs.org, Audioblog.com, and Vlogdir.com.) Blogging technologies typically incorporate a capability for remote posting of content by users of a given blog. As examples, in the case of textual blogs, posts can be made by computer either directly though the blog's Website interface, or through e-mail; audio bloggers can post recordings by telephone. Hence, blogs allow individuals to become roving correspondents, much like journalists (and publishers) in traditional news media.

REVIEW OF EXISTING LITERATURE ON BLOGGING

In an *Entrepreneur* magazine article titled, "Who Let the Blogs Out?," Kooser, observed that blogging has "gone beyond fad to become a full-fledged Internet phenomenon" (2002). The blogging phenomenon has been associated with a paradigm shift, and is so pervasive that the term "blogosphere," has arisen, defined as a "collective term encompassing all weblogs or blogs as a community or social network" (Blogosphere, 2006), in keeping with its immense proportions and social impact.

The Web site Technorati.com actively tracks numerous statistics pertaining to the blogosphere, and is widely regarded as a seminal source for such data. According to its estimates, which are updated continuously, Technorati tracks over thirty million blogs with 2.1 billion links. However, it should be noted that the rate of growth associated with the creation of new blog sites is extraordinary. According to an ongoing study conducted by the Pew Internet & American Life Project, one out of every twenty persons in the United States has created a blog (Rainie, 2006).

The need for this present exploratory paper became evident after a series of searches in the academic literature revealed that rigorous study of blogging as a variable under study in entrepreneurial research has been minimal. Search attempts conducted on databases used by *ProQuest* demonstrated a dearth of scholarly research on blogging in general, and sparse results once blogging terms and entrepreneurial terms were utilized in association with one another. The preponderance of results in the literature at large appeared to be typically associated with aspects of media and journalism, socio-cultural analyses, and the literature of communications.

With parameters for the searches set to select only scholarly journal articles with full-text availability and results in the citation and abstract, the low number of articles in search results from those in *ProQuest* databases suggested an opportunity for future studies of blogging as a hybrid entrepreneurial form, or as a tool which might impact entrepreneurial success or failure by virtue of its characteristics, such as an ability to allow organizations to create blogs for purposes of marketing outreach. Using the settings described above, terms used in combination with one another such as "entrepreneurship AND blog," "small business AND blog," "entrepreneur AND blog," and "weblogs AND small business," produced no returned results from the respective search queries. A search on the term "weblogs" returned only 73 documents.

In addition, the index sections of several leading entrepreneurship textbooks were consulted, and the two terms, "blog" and "weblog" (with variations thereof) were observed to be conspicuously absent. One publisher's brand new "flagship" entrepreneurial and small business academic textbook used in college and university entrepreneurship courses (copyright 2007) failed to list either the term "blog" or "weblog" in its index. It is presumed that the lack of coverage within leading entrepreneurship textbooks is a reflection of scant research in the literature.

Subsequently, search results derived from the use of Internet search engines encompassing the business press, practitioner journals, and magazines, revealed that, "blog" "blogging," "blogger," and the like were likely to produce millions of listed "hits" in search results. A *Google* search on the term "blog" returned the results statement: "about 2,070,000,000 for blog" (retrieved March 16, 2006). It should be noted that the author of this paper recognizes the inherent instability, bias, and lack of precision associated with commercial search engines.

However, as has been indicated, the body of scholarly literature available for review is limited, yet blogging is widely recognized as an important part of the entrepreneurial and landscape.

USES TO WHICH BLOGGING TECHNOLOGIES HAVE BEEN APPLIED

Relative to specific subjects and types of blogs that have proliferated on the Internet, virtually every topic imaginable has been touched upon. Blogs enable any individual or group to access what amounts to a publishing platform, through which they can address anything under the sun, and reach a worldwide audience while doing so. Individual bloggers are expressing their views from within or outside organizations, and developing audiences as a result of their commentary. One might critically observe that the Internet itself enabled Web site creators to reach the same worldwide audience. However, that analysis would short change an essential difference between static Web sites and blogs, which enable users with limited technical skills to create, and update their blogs with content which is (or can be) constantly refreshed.

The dynamic nature of weblogs is an attribute that is attractive to both frequent visitors as audience members who wish to stay current with the content addressed on one or more blogs, and to Internet search engines. Blogs are also associated with a variety of newsfeed aggregators, which allow individuals to subscribe and to be notified when blogs are updated. These newsfeed services can make blog reading a habitual behavior, much like viewing the weather, traffic, and local news might become a habit before heading off to work.

Blogs have been set up for myriad purposes and attract audiences accordingly. Blogs have been used effectively by individuals who have developed followings that are so large, that their authors compete head-to-head for attention and audience share with mainstream media pundits. As suggested by at least one study from Intelliseek (Blackshaw & Nazzaro, 2004):

Although influenced or stimulated by traditional marketers and marketing activities, online word of mouth is nonetheless owned and controlled by consumers, and it often carries far higher credibility and trust than traditional media, especially as media channels become more fragmented and less trusted. The growth of its influence poses challenges and opportunities for marketers. (p. 2)

BLOGGING AS A PLATFORM FOR PROFESSIONALS AND ENTREPRENEURS

For a number of reasons, but particularly because blogs are relatively inexpensive and easy to set up, small businesses have found that they can represent themselves through blogging platforms. Because blogs are updated dynamically, as compared to what might be described as predecessor Web site technology, which was static in nature (as introduced above) and also known as "brochure sites" (Baker, 2005). Blogs are rapidly becoming if not already recognized as a superior platform for small business marketing communications.

Hence, blogs are being used for purposes of marketing outreach. Real estate firms (Fleming, 2005), accountants (Geerts & Kim, 2005), attorneys (O'Keefe, 2006), and numerous other small businesses (Bender, 2006) have discovered the outreach potential of weblogs: even students have discovered the profit potential in blogging (DollFacePunk.com, 2006).

Professionals are using blogs to chronicle their observations, advice, and commentary as well as specific responses to public posts in a forum-like atmosphere. According to the site Lexblog.com (home page), a leading provider of turnkey blog sites for attorneys:

Lawyer blogs offer you marketing at its finest. They are more tasteful and less expensive than other lawyer advertising. Blogs are far superior to law firm Web sites in search engine rankings. Best of all your law blog enhances your reputation as a trusted and reliable authority in your area of the law....Lawyer blogs offer you a return to traditional law marketing. Your marketing will be education based. You'll be providing helpful information to current and prospective clients. Lines of communication will be established through a personal and down to earth approach of communicating with people. You'll be proud of the way you market your legal services.

Kooser's aforementioned *Entrepreneur* magazine article also quoted Peter Scott, whose site, The Weblogs Compendium, provides a comprehensive directory of blogging information. According to Scott: "For a small business, the beauty of using a Web log is that you can promote your business and you can also get other people to work with you on your business" (2002). Other implications for entrepreneurship teaching, research and practice have arisen through the literature review process associated with this present paper. For instance, blogging has emerged as a business unto itself, and a technology and marketing support community has emerged specifically to service the needs of small business and professional bloggers. Andy Wibbels, who calls himself a "blogging evangelist," (Wibbels, 2006) has published several electronic courses and books, and provides workshops and seminars. Wibbels has developed a series of products solely for individuals who wish to become full time blogging professionals and entrepreneurs. His products include titles and programs such as "Six Figure Blogging," "Blogwild," and "Podcasting Bootcamp," through which he provides training for professional bloggers who are reporting substantial incomes from their blogs, which they are operating as businesses unto themselves.

It is also the case that with "with very little or no money you can be on the Internet" (Shapiro, 2002), and as such, blogs might be considered ideal by bootstrappers. Numerous providers allow users to set up free blog accounts. This seeming generosity on the part of providers is typically supported through one or more means of revenue generation or support in other forms: 1) blogging communities, wherein individuals participate in an open forum-like atmosphere, including making technical and financial contributions as well as members' assisting one another; 2) blog accounts are free, but they incorporate advertising; 3) free blogs with limited services, such that the blogging account holder may choose to upgrade (perhaps after growing his or her blog from inception to a more substantial body of work, sometimes with a significant audience; 4) donations or tips; 5) other: such as direct sponsorship relationships or the sale of goods and services (ArticlesontheWeb.com, 2006).

Relative to communities, some bloggers have banded together as a collective to create social networks (and blogging networks). These blogging networks are otherwise known as "enterprise blogs" (Orr, 2004).

OPPORTUNITIES CREATED BY BLOGGING TECHNOLOGIES

Approached as a business unto itself, blogging has a number of appealing benefits. In particular, for those individuals who may have a serious hobby, musings about their personal or work lives, strong political views, or expertise on any subject, blogs provide a technological platform from which the blogger can broadcast his or her message. Although the overall number of blog readers and blog creators has not saturated the audience of Internet users, "readers and writers are highly influential" (Li, C., Bernoff, J. & McHarg, T., 2004). Hence, the adage "do what you love" has a real possibility of becoming a reality for a dedicated blogger, given an appreciative audience. According to an article in *MIT Technology Review* (Madden, 2005):

Several factors have contributed to the emergence of blogs. First, they can be started with very little, and very inexpensive, editorial content yet are capable of exerting extraordinary influence. Blogging software is inexpensive--or often free--and easy to use. Low bandwidth requirements and Web-hosting fees keep the ongoing infrastructure costs of maintaining a blog very low. And new, easy-to-use advertising services such as Google AdSense, which frees content creators from having to deal with actual advertisers, have breathed fresh life into online media….More-serious bloggers, however, have increasingly approached their sites as they would any other sort of editorial platform, with regular publishing schedules and clear editorial missions.

Hence, blogging, as a business, is suitable for bootstrappers, as it represents a low cost startup opportunity "to individuals who have little or no collateral, little or no cash, little or no entrepreneurial experience, little or no training, and little or no choice but to pursue an entrepreneurial dream without the benefit of resources which would ordinarily be nice to have" (Lahm, 2005).

BLOGGING REVENUE SOURCES

As derived from the publication, *Making Money Blogging on the Side: For Stay-at-Home-Moms and Dads, Students, and Anyone Else Who Needs Extra Cash*, (ArticlesontheWeb.com, 2006), bloggers often have multiple ways to generate revenue streams. A short list of these might include: 1) advertising arranged through formally established affiliate programs such as Google AdSense; 2) direct sponsorships; 3) the sale of ancillary products such as calendars, t-shirts and bumper stickers; 4) consulting services as arranged based upon the expertise of the blogger (and as evidenced by the blog itself); 5) the sale of published products or compilations of blog content in the form of electronic publications as well as those created through traditional publishing technologies.

Glenn Reynolds, who is otherwise employed as a Law Professor by the University of Tennessee, operates a weblog known as Instapundit.com. Reynolds utilized advertising content in his blog from a North Carolina based advertising brokerage company called BlogAds, which has arisen specifically for the purpose of matching bloggers with advertisers. As observed by Pender (2004):

> Reynolds says he's been pleasantly surprised at the results. Ads on his site cost $375 a week ($1,000 a month), and he made $4,000 in each of the last two months. "I don't think I'll make that much this month. There's an initial wave of excitement which is likely to phase out," he says. His site gets about 150,000 page views and 110,000 visits per day.

BLOGGING AS A PUBLISHING PLATFORM

Blogging, as an activity that is based on creating a body of content, also has interesting implications relative to traditional publishing. (Indeed, a Google search conducted on March 14, 2006, using the phrase "blogging book deal" returned 1,380,000 hits.) Journalists are searching blogs for the latest "buzz," and bringing bloggers to the attention of agents (Radosh, 2004). According to one review article written by an author who is also employed at Google and assigned to its Blogger in an titled, *How To Get A Book Deal With Your Blog*, some bloggers have been approached by book industry representatives and presented with publishing contracts (Stone, n.d.).

One such author (cited by Stone, above), is a Long Island City, New York, secretary named Julie Powell who decided to cook 536 Julia Child recipes in 365 days and recount her experiences on her weblog in an effort that she dubbed the "Julie/Julia project" (Powell, 2003). According to Powell's own account:

> So, the cat's out of the bag already, a bit, but I should tell you all officially. There's no easy way to say this -- certainly not without arousing the ire of those who may think I've already gotten Too Big For My Britches. But it's true. I have landed a book deal. A *really* obscene book deal. I am, in fact, officially What's Wrong With Publishing Today. For which I am endlessly grateful, not to mention a wee bit terrified.

Bloggers who build an audience may also create media attention, and are therefore perceived (perhaps correctly so) as authors who are likely to be effective at marketing their books (Kremer, 1988).

CONCLUSION

According to a February 2006 report published by Technorati's founder, David Sifry, "the blogosphere is over 60 times bigger than it was only 3 years ago" (Sifry, 2006) and growing at a rate of 75,000 new blogs, per day. Sifry further estimates that the growth rate also means that "on average, a new weblog is created every second of every day" (2006). Beyond the business press, mainstream news and media outlets have swarmed around the subject of blogging. The Internet powerhouse Google.com has now purchased one of the most popular free blogging membership sites on the Internet (The Story of Blogger, 2006). Numerous other technology companies are actively developing products and services to address the needs of emerging blogs, as a viable market.

Blogging has been called a "paradigm shift of how we disseminate and communicate" (Cunningham, 2005) and a "key part of online culture" (Rainie, 2005). As this paper suggests, blogging is a phenomenon that deserves far more attention from scholarly researchers. Given the relevance of the subject to the practical community, entrepreneurship researchers in particular should aggressively pursue blogging as a subject under study in their future scholarly endeavors.

REFERENCES

ArticlesontheWeb.com (2006) *Making Money Blogging on the Side: For Stay-at-Home-Moms and Dads, Students, and Anyone Else Who Needs Extra Cash.* Retrieved March 11, 2006, from http://ArticlesontheWeb.com

Baker, K. (2005, January 3). Why "Brochure" Sites Don't Generate Results. Retrieved January 22, 2006, from http://www.morningstarmultimedia.com/html/2005/01/why-brochure-sites-dont-generate.asp

Bender, E. (2006, April). New Playing Fields: The Internet is Rapidly Evolving, and Entrepreneurs Are Finding Creative Ways to Keep Up. *Entrepreneur* [The Extended Office, special section], 18-19.

Blackshaw, P. and Nazzaro, M. (2004, Spring). Consumer-Generated Media 101: Word-of-Mouth in the Age of the Web-Fortified Consumer. *Intelliseek.com*. Retrieved March 1, 2006, from http://www.intelliseek.com/whitepapers.asp

Blog. (2006, March 11). *Wikipedia.* Retrieved February 16, 2006, from http://simple.wikipedia.org/w/index.php?title=Blog&oldid=108392

Blogosphere. (2006). Wikipedia. Retrieved 20:00, March 16, 2006 from http://en.wikipedia.org/w/index.php?title=Blogosphere&oldid=42124239

Cunningham, S.L. (2005, September 25) Blogging - A Paradigm Shift of How We Disseminate and Communicate. Retrieved January 2, 2006, from http://blogcritics.org/archives/2005/09/25/180038.php

DollFacePunk.com. (2006, January 1). Entrepreneurial College Student Finds Financial Independence. *PRWeb.com*. Retrieved February 4, 2006, from http://www.prweb.com/releases/2006/1/prweb339964.htm

Fleming, S. (2005, October). Blogging for Business: Some Experts Say Blogging May be Small Talk, but Ultimately it can Lead to Deal Making. *National Real Estate Investor*, 47(10, 16.

Geertz, G. L. and Kim, M. (2005) Blogging 101 for CPAs. *CPA Journal*, 75(7)12-13

Kooser, A. P. (2002, October). Who Let the Blogs Out? *Entrepreneur.com.* Retrieved March 2, 2006, from http://www.entrepreneur.com/article/0,4621,303129,00.html

Kremer, J. (1998). 1001 Ways to Market Your Books, 5th ed. Fairfield, IA: Open Horizons.

Lahm, R.J. (2005). Before You Take the Entrepreneurial Plunge, Consider Various Business Models. *EntrepreneurshipClearinghouse.com*. Retrieved October 16, 2005, from http://entrepreneurshipclearinghouse.com/articles/businessmodels.html

Li, C., Bernoff, J. and McHarg, T. (November 5, 2004). Blogging: Bubble Or Big Deal? When And How Businesses Should Use Blogs. *Forrester.com*. Retrieved March 16, 2005, from http://www.forrester.com/Research/Document/Excerpt/0,7211,35000,00.html

Madden, A. (2005, August). The Business of Blogging: Could it make money? *MIT Technology Review*, 36-38.

O'Keefe, K. (2006, January 23) 57 % of lawyers reading blogs, 19 % authoring blogs. Retrieved February 11, 2006, from http://kevin.lexblog.com/advantages-of-lawyer-blogs-1837-57-of-lawyers-reading-blogs-19-authoring-blogs.html

Orr, B. (2004, October). Blogging for Profits. *ABA Banking Journal*, 96(10), 106.

Pender, K. (2004, May 30). Bloggers find ways to profit. *San Francisco Chronicle.* Retrieved March 8, 2006, from http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2004/05/30/BUGO76TL221.DTL

Podcasting. (2006, March 16). *Podcasting Glossary.* Retrieved March 16, 2006 from http://www.podcastingnews.com/topics/Podcasting_Glossary.html

Powell, J. (2003, September 22). The Julie/Julia Project. Retrieved March 14, 2006, from http://blogs.salon.com/0001399/2003/09/22.html

Radosh, D. (2004, May). A Book in You. The New Yorker. Retrieved March 14, 2006, from http://www.newyorker.com/talk/content/?040531ta_talk_radosh

Rainie, L. (2005, May). New data on blogs and blogging. *Pew Internet & American Life Project*. Retrieved March 11, 2006, from http://www.pewinternet.org/PPF/p/1083/pipcomments.asp

Shapiro, A. (2002, May 6). Audio Blogs: Online Diarists Sound Off; Web Journals Now Feature Voices, Other Sounds. *NPR.org.* Retrieved March 16, http://www.npr.org/templates/story/story.php?storyId=1220496

Sifry, D. (2006, February). State of the Blogosphere, February 2006 Part 1: On Blogosphere Growth. Retrieved March 1, 2006, from http://www.sifry.com/alerts/archives/000419.html

Stone, B. (n.d.) How To Get A Book Deal With Your Blog. Retrieved March 14, 2006, from http://help.blogger.com/bin/answer.py?answer=674&topic=35

The Story of Blogger. (2006). Blogger.com. Retrieved February 6, 2006 from http://www.blogger.com/about

Wibbels, A. (2006). Six Figure Blogging. Retrieved March 12, 2006 from http://articlesontheweb.com/dir/andywibbelsproblog.html

INDEPENDENT CONTRACTOR CLASSIFICATION: THE CHALLENGE OF DOING IT RIGHT

Patricia Borstorff, Jacksonville State University
Stan Newton, Jacksonville State University

ABSTRACT

At a recent White House Conference on Small Business, attendees rated independent contractor (IC) classification disputes as the most pressing small business issue. The Internal Revenue Service (IRS) claims it loses billions of dollars each year in employment and income taxes due to improper classification. Over 8 million independent contractors are in use in the US and this number is expected to double within the next ten years. The current rules are complicated, confusing, and subjective; clarification and simplification of the existing worker classification guidelines is necessary. A survey of small businesses was conducted in a southeastern state concerning determination and use of independent contractor status. A second study was conducted with educational institutions with a slightly modified survey. We found that a third of the universities and colleges had policies in place for determining status of workers whereas smaller employers did not have a procedure to follow and appeared to be unconcerned with this lack of procedure. Both groups reported confusion in classifying workers properly.

INTRODUCTION

The General Accounting Office estimates that the government loses $20 billion annually to employees misclassified as independent contractors (IC). The Internal Revenue Service (IRS) estimates that only 15% of ICs pay the proper amount of taxes but 90% of W-2 employees pay their proper share. Many firms are unaware that they may be violating the law. The Acting Commissioner of Internal Revenue testified before Congress, stating, "One of the most difficult and controversial issues in the employment tax area is the definition of 'employee'….The rules are confusing to employers." But at an IRS audit, the company has the responsibility to support, by a preponderance of evidence, the independent status of their ICs (Independent contractor/returning retiree issue, 2005).

The reclassification by the IRS of workers from independent contractors to employees can be devastating to small business owners. Such reclassification often subjects a business to payment of back federal and state taxes, penalties and interest. And, if the IRS thinks that the employer actually knew better or should have known better, the taxpayer, its employees, and its tax advisors could be faced with criminal charges (Sbarbaro, Reese & Miller, 1990).

Independent contractors who are reclassified as employees may also be eligible to receive back benefits including insurance, retirement, profit sharing and stock options. This could be very costly to a small business, possibly leading to liquidation or bankruptcy.

Reclassification of IC's to employees can conflict with benefit calculations on retirement plans and tilt the plans toward the highly compensated employees which could result in the potential loss of tax qualified status (Goldberg, 1999). The benefits issues have been highly publicized in light of the recent Microsoft and Time Warner suits, but this is beyond the scope of this research.

The purpose of our research is to investigate tests for worker classification and determine employer usage of independent contractor policies. We were interested in employers' usage of ICs and their perceived ease of use of this classification.

INDEPENDENT CONTRACTOR OR EMPLOYEE

According to the Bureau of Labor Statistics (2005), at least 60% of all businesses use independent contractors and over 8 million ICs are in the work force. This is in sharp contrast to the 1950's "organization man" who worked for one organization full time for the balance of his career (Brady, 1998). The number of people working as independent contractors is increasing exponentially each year; in part, due to telecommuting, as virtual offices are being recognized as efficient modes of operation. Some people make the conversion to IC by choice while others have the independent status thrust upon them after corporate cutbacks (Fishman, 1997).

Determining the status of a worker goes well beyond referring to him or her as an independent contractor, arranging a written contract, or having the payment methods set up correctly. The important factor in determining worker status is identifying the relationship between the worker and the organization (Morfeld, 2002).

ICs are people who contract to perform services for others but do not have the legal status of employees. An individual may be classified as an IC if the employer has the right to determine the quality of the work but not the means or method of accomplishing the work (IRS Publication 539). The IC works on an irregular basis, is paid upon task completion, and is not subject to an employer's direction and control. The IC provides his or her own tools and equipment, purchases his or her own benefits, pays taxes independently from their employers, and is responsible for personal training and development (Berson, 2003; Gee & Knight, 1999; Zollars, 1996).

In contrast, an employee works at the direction and control of an employer on a regular basis. The employer dictates the tasks to be accomplished and the process by which the result is obtained. The employer provides salaries, benefits, and training to the employee. Employers are required to deduct and withhold a percentage of wages to be paid to the taxing authorities for income tax and social security purposes. An employee's success and financial growth are tied to the organization's future development. Employees usually have more job security than ICs. An employee is hired for a contract *of* services whereas an independent contractor is hired for a contract *for* services (Scott, 2004).

ADVANTAGES AND DISADVANTAGES OF IC USE

There are many advantages for businesses to use ICs. If an organization has cyclical demands, contracting on a one-time or short-term project can be cost effective. The IC is paid to complete a task at a predetermined fee, without associated benefit costs which average 30 - 40% of a typical employee's salary. ICs have a specialized skill or expertise that may not be available within the organization and may be used as a neutralizer to resolve difficult situations. ICs can provide a level of flexibility to an employer that cannot be obtained with employees. Experienced ICs can save the business time and the expenses involved in training and allow the business to expand and contract their workforce as needed, quickly and inexpensively. Additionally, ICs can deduct costs that employees can not, their pay is not subject to withholdings, and the firm's payroll taxes for ICs are lower; in the large part, because FICA and State Unemployment Insurance taxes are the IC's personal responsibility.

Misclassification can have serious financial consequences for the organization. The burden of proof is on the employer. Both state and federal agencies determine worker status; each has different legal tests and different reasons for concern with worker classification. The IRS, state unemployment compensation agencies, state workers' compensation insurance agencies, state tax departments, the US Department of Labor, and the National Labor Relations Board have a interest in the proper classification of workers; each agency determines classification independently (Fishman, August 21, 1997). Independent contractors are misclassified on a regular basis. According to the GAO, an estimated 38% of employers have misclassified workers as independent contractors (Stump & Sprohge, 2004).

Issues may arise regarding fair wages under the Fair Labor Standards Act, resulting in an investigation by the US Department of Labor. The previously mentioned state agencies have vested interests in the payment of income taxes or insurance premiums. Misclassification of an employee as an IC can result in fines and penalties being assessed by any of these agencies (Fishman, August 21, 1997).

If the Internal Revenue Service audits an organization and determines that employees have been misclassified as independent contractors, then the organization must pay the IRS all back taxes owed, with interest and penalties. Often employees have agreed to misclassification in order to reduce the amount withheld. The IRS can impose personal liability upon the "responsible party" who has failed to properly pay taxes. And the Department of Justice can enter the case with criminal charges. This situation can be particularly egregious as tax liabilities and activities thought to fraudulent are often not avoided by bankruptcy proceedings. Nor are they always protected by the corporate shield and maybe considered personal responsibilities.

CURRENT IRS TEST

The Internal Revenue Service uses the common law right of control test as an analytical tool for determining worker status as outlined in Revenue Ruling 87-41 (The 20 Factor Test). This 1987 ruling developed a list of 20 factors to use as guidelines in measuring control under the common law test. No one factor is decisive; in fact, all 20 factors will rarely be met. The stipulations in these guidelines generally refer to the required independence of IC's. Reference is made to an independent contractor's freedom from an employer's mandates; for example, training and instructions, set hours of work, requirement of full time status, and typical controls of how the work is to be performed. The entire 20 Factor Test may be viewed in Appendix A.

In 1997 the IRS released a new training manual for employment tax specialists and revenue officers incorporating provisions of the Small Business Job Protection Act of 1996. The manual advises reviewers to weigh the evidence in entirety to determine if evidence of control or autonomy predominates. The most persuasive evidence of control in determining worker status is derived from three categories: behavioral control, financial control, and the relationship of the parties. Behavioral control focuses on the right to direct or control how the work is done. Financial control focuses on payment methods, services available to the relevant market, un-reimbursed expenses, and the opportunity for profit or loss. Relationship of the parties focuses on how the parties perceive their relationship. Contracts, permanency, and regular business activities are relevant in determining the relationship (IRS training materials, 1997). While philosophical in nature, at the practical level, the subjective interpretation inherent in these criteria further erodes the distinction between the two categories. From personal experience, as an employer and an IC, I have found it unreasonable to expect employers to accept so little control as that implied by the ambiguity of these guidelines.

SAMPLING OF INDUSTRIES

Every industry has a different set of issues concerning the determination of IC or employee status. Because the 20 Factor Test developed by the IRS is subjective, a consistency in application is difficult and there is great disparity in the frequency of hire and the types of positions under scrutiny. Also even different courts vacillate about classification of occupational categories. For example, between 1955 and 1975, the IRS and the courts issued six conflicting rulings concerning the classification of "gypsy chasers." (Gypsy-chasers are individuals who contract with a truck driver to unload furniture or other freight. Final verdict: they were ICs) (Sbarbaro, 1990). And our survey found that regardless of industry, it is an issue for all employers.

While the IRS does not and will not rank the factors for relevance in the determination of worker status, a review of literature yielded two previous studies that examined independent contractor court cases. Each of these studies analyzed the 20 IRS factors and ranked their relative value.

In the first study 40 cases were reviewed: they found that the court did not view all factors equally (Sumatka, 1992). The authors grouped the factors referenced in the cases under two general headings: "right to direct details of work" and "trade or business characteristics." Four of the factors (instruction, hours and sequences, right to hire, and payment and supervision of assistants) were grouped under the general heading of "right to direct details of work." Four other factors, (method of payment, realization of profit or loss, furnishing of tools and equipment, and investment in facilities) were labeled "trade or business characteristics."

In a similar study, Burns and Freeman (1996) reviewed 20 court cases and were able to identify five factors that best predicted outcome. The more often a factor appeared in a case, the more weight it carried as an indicator. The authors selected five factors as the best predictors: instructions, furnishing of tools and equipment, significant investment, method of payment, and realization of profit or loss. When they applied these factors to 20 cases, they obtained a prediction accuracy rate of 90%.

These findings clearly imply that while the factors relating to trade or business characteristics and the right of control are the most influential in determining case outcomes, control is the most important. The greater control exerted by the employer over the work performed by the individual, the more likely the courts are to rule in favor of employee status.

RESEARCH METHODOLOGY

A survey was conducted with sixty organizations in a rural county in a southeastern state. This was a convenience sample where one of the researchers was friends with a business person in that area. The majority of the surveyed organizations (60%) were in the manufacturing and engineering field. Each participating organization had less than 500 employees, with 87% having 100 or less. The atmosphere of the workplaces and the business style of each organization differed significantly as some 32% (19) companies were very small (<30) employees. The questions asked about procedures utilized for determining independent contractor or employee status. We were interested in seeing the attention or lack thereof paid to classifying independent contractors. The survey is attached at the end.

RESULTS

The first question asked at what level in the organization was worker status determined. Fifty percent (30) of the participants replied that this decision was made by the owners, 40% (24) the Human Resources Department, and 10% (6) the supervisor.

When asked whether they had established a procedure of guidelines or a questionnaire to determine worker status, a resounding 90% (54) of the participants responded no to this question. They did not have dollar payment limit or number of days-worked limit in relation to determining independent contractor classification. This could relate to the small size of many of the organizations. This minimal concern about misclassifying workers could be a lack of knowledge of the seriousness and expense of a mistake. Only ten percent (6) had an internally published list of positions that were considered independent contractors.

Another question posed was if the organization had requested a Determination of Employee Work Status form from the IRS. None of the participants had done so. Ninety-five percent (57) felt that the determination of independent contractor status was not an issue in their company. The participants who offered comments stated that this was not an important issue to them because they were small businesses. (However, they are incorrect in this assumption). In fact, one respondent wrote that if the applicant was doing something not really important to the company, then he did not classify them as an employee. None were interested in asking the IRS for assistance in determining worker status. Several wrote that they did not want to ask the IRS for any help in anything. None of the organizations had been audited. Our conclusion from the survey is that in rural areas of the state, business owners and managers are dismally uninformed about classification of independent contractors and potential liability for their ignorance. Since none had been audited, they believed the classification to be a non-issue.

COLLEGES AND UNIVERSITIES

The same short survey modified for education institutions was sent to colleges and universities in the same southeastern state with 31 usable surveys returned. Respondent's business practices and personal experiences were reflected in the ten-question survey. Thirty-seven percent of the respondents confirmed the hypothesis that proper classification of independent contractors is difficult.

RESULTS

The survey reveals that the majority of those surveyed (69%) handle the independent contractor issues on a case-by-case basis with little structure in the process other than a subjective analysis of the IRS 20 Factor test. The decision to employ and the responsibility of classification usually fell with the hiring department (57%); human resources department (38%); and 5% with joint responsibilities. Only 7% of those surveyed have ever requested determination of classification from the IRS, citing the process too slow to be practical. The IRS had audited 21% of the organizations surveyed, with some penalties and damages incurred. Thirty-seven percent believed the independent contractor/employee classification to be a significant issue within their organization.

Our sample showed that only 31% had developed questionnaires or checklists from the IRS 20 Factor Test for internal use. Only one institution in our sample had used a dollar payment limit or a number of days-worked limit to determine worker status. As stated previously, there are variations in interpretation based on the subjective evaluation in determination of worker status. In higher education, the most frequently debated payments have been to adjunct faculty, instructors of non-credit courses (continuing education), guest performers or artists, guest speakers or lecturers (short duration because of expertise), and providers of professional or advisory services.

DISCUSSION

Adjunct faculty members' primary employment is usually elsewhere. They teach one or more courses per term. The college or university determines curriculum, provides materials and sets the class schedule. The university has the relationship with the student, not the adjunct faculty member. The faculty member has an ongoing relationship, only until the end of the term, with the university. A course may be cancelled or either party may terminate the relationship without liability. It does not matter that the university allows the employee considerable discretion and freedom of action, as long as the university has the legal right of control of services delivered. Universities surveyed viewed adjunct faculty as employees.

Instructors of non-credit courses (continuing education) are often considered employees based on the logic for adjunct faculty. However, if the non-credit instructor has an established business for the purpose of providing services to multiple clients, then the person may be considered an IC. Revenue Ruling 70-308 determined part-time instructors for certain occupations in the airline industry teaching non-credit courses are employees of the school. In IRS Letter Ruling 9219020, the IRS determined that an employee who performed 95% of his or her services for one employer, and only 5% to other entities was truly acting as an employee rather that as IC. A common area where this situation occurs is with those instructors who teach continuing education courses (Texas A & M University, 1998). The non-credit course category had the most variations in our survey, making it imperative that the status of instructors of non-credit courses be assessed on an individual basis.

Guest performers and artists who are not otherwise affiliated with the university may work at an event or series of events. Frequently musicians, artists, actors, noted authors, comedians, and various other performers and artists in this category are considered ICs.

Payments to guest speakers, or lecturers (short duration) are frequently paid as an honorarium. Payment for services is not contingent upon a particular result. The amount of the honorarium is generally determined according to custom rather than by business market practice. These individuals are usually from outside the university and lecture on their specific expertise. Depending on the interpretation of the IRS 20 Factor Test, varying conclusions can be drawn; however, the majority of institutions surveyed treated this group of individuals as ICs.

Providers of professional or advisory services are usually considered to be ICs. Examples of these are health care, accounting, legal, or professionals who possess a special expertise and are brought in for policy development, curriculum review or other areas in an advisory capacity.

DISCUSSION OF SMALL BUSINESS

The 1995 White House Conference on Small Business called for Congress to require that only one of four criteria, along with a written agreement, be required for making the IC designation. This group recommended the four criteria to be the realization of a profit or loss; separate principal places of business; making services available to the general public; and paid on a commission basis. Small business owners' perception and definition of an IC are quite different from that of the courts or the IRS. Small business owners' misunderstanding of the IRS's interpretation of its 20 Factor Test criteria may explain much of the misclassification that occurs. Our business sample surprised us with the lack of information and subsequent lack of concern over worker status. In interviewing some of the participants, the common refrain was that they were trying to stay in business and that worker status was not on the front burner for them.

Some of the educational institutions did have a better procedure for worker status. We found it troubling that colleges and universities who teach business practices are not following the appropriate procedures. The human resource managers at the educational institutions considered worker status to be a serious issue for them. Perhaps the fact that several had been audited and paid penalties for their mistakes made them more cognizant of the issue.

Further research would be of interest in the worker classification area. We do not believe that this one state is significantly different than others in knowledge and proper use of correct worker status. If nothing else is taken from our research, we would suggest that worker status classification could be a profitable training seminar area for a business professor to offer.

MISTAKES AND PENALTIES

Some common mistakes raise a red flag for the IRS. Assuming a written agreement is all that is needed or rehiring a former employee or retiree as a consultant in the same function will catch the eye of an auditor. Other quick ways to alert the IRS are inconsistent treatment of workers and/or the use of ICs in the integral functions of the business. Workers with similar titles, performing similar tasks, should be classified the same. Never consider a temporary employee or a rehire to be an IC when there are employees doing the same type of work. Never outsource your core competencies. The more central the function and the deeper the task is integrated within the business structure, the higher the scrutiny on whether the worker is an independent contractor or an employee (Flynn, 1997; Zahorsky, 2004).

Unintentional misclassification of an employee limits an employer's liability for income taxes to 1.5% of the employee's wages. The employer's liability for FICA taxes that should have been paid by the employee would be limited to 20% of that amount**.** The employee may also be assessed penalties related to the failure to withhold. If a business fails to file a Form 1099, the penalties and interest are doubled. The burden of payment is all on the employer and may not be recovered from the employee (Mister, 2001).

Intentional misclassification of employees as ICs has much steeper penalties. The employer is responsible for the full amount of income tax that should have been withheld, and the full amount of employee and employer FICA tax, interest and penalties (Employee vs. independent contractor debate, 2005). The most troubling part of this is that the IRS decides "intent." If the IRS thinks that the employer knew, or should have known better, criminal charges can be filed. A case can be made that an employer holding a degree in business should have known better. Finally, when the IRS believes the misclassification to be ‘willful’, criminal charges can follow (IRS Publication 539).

LET THE IRS DETERMINE STATUS

Subtle distinctions make the difference between employees and ICs. Businesses may request a determination of a worker's status by filing a Form SS-8, "Determination of Employee Work Status" with the IRS. This process is too slow to be practical, because employers and individuals must know in advance how workers will be classified for tax and wage and hour purposes, rather than having after-the-fact determinations made by government officials. However, even in light of the above, the aforementioned penalties may be accessed in any misclassification.

GUIDELINES FOR REDUCING THE RISK OF HIRING INDEPENDENT CONTRACTORS

The risks associated with hiring ICs can be minimized by a few common sense precautions. Use written agreements to avoid misunderstandings about services the IC is to perform, payment, deadlines, and related details. Written agreements should incorporate some or all of the IRS 20 Factors and require the worker to comply with the tax obligations of the IC status.

Obtain taxpayer identification numbers and file an IRS Form 1099 for any unincorporated IC you pay $600 or more in any year for work done in your business. Pay ICs on the payable system and require ICs to invoices for payment. Do not pay ICs on the payroll. Remember to be consistent in the way ICs are used and separate the type work your employees and ICs do.

Allow the IC to determine where and how to accomplish the task and work hours without supervision. It is up to the IC to deliver the agreed upon work. The organization may choose to accept or reject the final results. Do not give ICs office space or free equipment unless you charge the IC and they sign an equipment or office space agreement.

Hire incorporated ICs when possible. This hires the corporation and not the IC personally. Establish a file for each IC and keep good records. Retain contracts, invoices, copies of 1099 forms, and any other information that shows the worker is operating an independent business. This may include the IC's business card, stationery, listing of other companies for whom services are performed, or a copy of their yellow pages listing. Always keep IC records separate from your personnel files. Obtain a written agreement transferring copyright ownership if you hire an IC to create a written work, art, music, photo, or other work of authorship. It is best to have the IC sign such a transfer agreement ahead of time (Fishman, August 21, 1997).

CONCLUSIONS

Misclassification is a significant and complex problem for employers and for the IRS. Companies need not shun the use of ICs. The best way to avoid errors resulting in extra costs and penalties is to develop proactive employment policies and procedures. Conduct a self-audit of independent contractor practices within your organization. Focus on workers' classification based on the criteria used by the IRS, the Department of Labor, and other government agencies that the courts rely on. Determine where independent contractors are working within your organization, for how long, under what circumstances, and the type of work they are doing. If an IRS audit is performed at a later date, the organization's exposure to penalties can be reduced if good faith effort to comply can be demonstrated. If you prefer an impartial opinion of your employment practices, hire a tax accountant, tax attorney or other expert to review case by case positions within your organization. Prevention remains the best cure.

REFERENCES

Berson, Susan A. (2003, March). Distinguishing Between Independent Contractors and Employees: Part I. *Corporate Business Taxation Monthly.* 12-20.

Brady, Teresa. (1998, January). Are they employees or independent contractors? *Management Review.* 44-45.

Bureau of Labor Statistics, Department of Labor, Washington D.C. www.stats.bls.gov

Employee vs. independent contractor debate. (1999) [on-line]. www.paychex.com/payingee/ library/ indepen.html

Fishman, Stephen. (1997). Pros and Cons of the independent contractor's life [on-line]. www.nolo.com/ic/ProsCons.html

Fishman, Stephen. (1997, August 21). Independent contractors: Top 10 tips for employers. *Business Week* [on-line]. www.businessweek.com/enterprise/news/en70821b.htm

Flynn, Gillian. (1997, September). Independent contractor vs. employee: Get it right. *Workforce*. 125-127.

Gee, Edgar, Jr. & Knight, Michael J. (1999, December). Independent Contractor or Employee: How the Process Works Today. *CPA Journal* [on-line]. http://weblinks3.epnet.com.lib-proxy.jsu.edu

Goldberg, Adin C. (1999 February). The dangers of misclassifying workers. *Management Review*. 62.

Independent contractor/returning retiree issue. (2005) [on-line]. www.prounlimited.com/icissue.htm

Independent contractors. (1998, November) SHRM Legislative fact sheet. [on-line] www.shrm.org/government/factsheets/fact-ic.asp

IRS Publication 539, Employment Taxes.

IRS training materials: Independent contractor or employee? (1997, March) [on-line]. www.starkman.com/articles/indepcon.htm

Mister, William G. (2001, April). The Contingent Workforce-independent contractors or Temporary workers. *Internal Auditor* [on-line]. www.findarticles.com/p/articles/mi_m4153/is_2_58/ai_73750453/

Morfeld, Christina. (2002, November). Employee or Independent Contractor? 20 Questions to ask when classifying a worker [on-line]. http://accounting.smartpros.com/ x35777.xml

Muto, S.heila. (1999, May 19). Bill to assist self-employed gets new life. *Wall Street Journal*. CA1.

Robbins, Renee D. & DeFatta, J. A. (1997 November/December). Independent contractor versus employee: The risks of reclassification. *Business Horizons*. 70-77.

Sbarbaro, Philip L., Reese, Rex E., & Miller, Max E. (1990). When misclassification becomes a Crime. *The Human Resources Professional*. 55-60.

Satagaj, J. (1999, April). Senator bond "drops" two small business bills. *Agency Sales*. 29.

Scott, Jennifer. (2004, October). Employee or Independent Contractor? [on-line]. www.gowlings.com/resources/publications.asp?pubid=1028

Stump, Mitchell L. & Sprohge, Hans. (2004, May). Independent Contractor or Not? *Journal of Accountancy* [on-line].http://web4.infotrac.galegroup.com.lib-proxy.jsu.edu/itw/infomark/732/188

Texas A & M University. Current issues in higher education. (1998) [on-line]. www.sago.tamu.edu/sobo/TaxManual/EmpInd.html

www.paychex.com.

Zimmermann, Raymond A. & Gowan, Mary A. (1999, January). Determinants of independent contractor status: Outcomes of U.S. court cases. *Journal of Small Business Management*. 14-28.

Zahorsky, Darrell. (2004). The Great Debate: Employee vs. Independent Contractor. *Your Guide to Small Business Information* [on-line]. http://sbinformation.about.com/cs/laborlaws/a/contractor_p.htm

Zollars, Ed. (1996). Employee/independent contractor page. Including revenue rulings.[on-line]. www.wnwr.com/taxation/ic/htm

APPENDIX A
REVENUE RULING 87-41 (THE TWENTY FACTOR TEST)

1. *Instruction:* A worker that is subject to instruction about when, where and how to work is usually an employee. (Revenue Ruling 68-598, 1968-2 C.B. 464, and Revenue Ruling 66-381, 1966-2 C.B. 449.)
2. *Training:* An employee is more likely to receive training by the employer than an IC. (Revenue Ruling 70-630,1970-2 C. B. 229.)
3. *Services vital to operation of organization:* If the worker is subject to the typical controls of the business over how work is performed, then the individual is an employee. An employee's services are usually integrated into the business operations and are essential to the success of flow of business. (United States v. Silk, 331 U.S. 704 1947, 1947-2 C. B. 167.)
4. *Services rendered personally:* The greater flexibility given the worker to designate who may perform service favors an IC status. (Revenue Ruling 55-695, 1955-2 C. B. 410.)

5. *Hiring, supervising, and paying for a worker's assistants:* An IC can hire, supervise, and pay assistants under a contract that states only required outcome. (Compare Revenue Ruling 63-115, 1963-1 C. B. 178, with Revenue Ruling 55-593 1955-2 C. B. 610.)
6. *Regular and continuing relationship:* If there is a long-term relationship without breaks, then the status is more likely to be employee. (See reference #3)
7. *Set hours of work:* ICs usually set their own hours. Employees work at the direction of the employer. (Revenue Ruling 73-591, 1973-2 C. B. 337.
8. *Requirement of full-time work:* ICs are free to work when and for whom they choose. Employees usually work for one business. (Revenue Ruling 56-694, 1956-2 C. B. 694.)
9. *Working on employer premises:* An employee usually works on the premises of an employer. (See reference #8)
10. *Set order or sequence of work:* ICs have greater freedom than employees do to establish sequence of work performed. (See reference #8)
11. *Reports:* Providing written or oral reports usually reflects employee status. (Revenue Ruling 70-309, 1970-1 C. B. 199, and Revenue Ruling 68-248, 1968-1 C. B. 431.)
12. *Payments:* ICs are usually paid by the job. Employees are paid by the hour, week, or month. (Revenue Ruling 74-389, 1974-2 C. B. 330)
13. *Expenses*: ICs are responsible for paying their own expenses. (Revenue Ruling 55-144, 1955-1 C. B. 483.)
14. *Tools and Materials:* ICs furnish their own. (Revenue Ruling 71-524, 1971-2 C. B. 346.)
15. *Investment:* ICs usually invest in and maintain their own work facility. (Revenue Ruling 71-524, 1971-2 C. B. 346.)
16. *Profit or loss:* While employee pay may reflect the profits and losses of the organization, an IC sustains a loss or profit on every job. (Revenue Ruling 70 -309)
17. *Work for more than one business:* ICs frequently work for more than one business. Employees are less likely to do so. (Revenue Ruling 70-572,1970-2 C. B. 221)
18. *Making services available to the general public:* An IC must be able to solicit employment from the public. A common way is by printing up business cards, yellow pages or other advertising. (Revenue Ruling 56-660)
19. *Right to fire:* An employer exercises control over its employees through the threat of termination. ICs usually cannot be discharged as long as they meet their contractual obligation. (Revenue Ruling 75-41, 1975-1 C. B. 323)
20. *Right to quit:* An employee can end a work relationship for no reason or good reason. An IC who quits before completing a job will breach a contract. (Revenue Ruling 70-309 IRS Publication 539; Robbins & DeFatta, 1997; Zollars, 1996)

SURVEY
INDEPENDENT CONTRACTOR OR EMPLOYEE STATUS?

Every industry has a different set of issues concerning the determination of independent contractor or employee status. The 20 Factor Test developed by the IRS is subjective and consistency in application is difficult. The independent contractor determination can cost employers a great deal in back taxes and penalties, benefits, and potential loss of qualified tax status.

Please assist our research by answering the questions to the best of your ability. Thank you for your help.

1. At what level in the organization is the final determination of employee status made?
   HR ______ Supervisor _____ Ceo/owner _______
2. Do you have an internally published list of positions that are considered independent contractors? _____yes _____no.
3. Do you have a $ payment limit that allows payment as independent contractor if below that amount? _____yes _____no. Comments?
4. Do you have a number of days-worked limit that allows payment as independent contractor if below that amount? _____yes _____no. Comments?
5. Have you established procedure guidelines and/or questionnaires to determine status? _____yes _____no. How effective is this process?
6. Is the completion of employment forms for those determined to be employees completed by the _____hiring department _____centralized office?
7. If you want the IRS to determine whether a worker is an employee, you can file a Form SS-8, "Determination of Employee Work Status." Have you ever requested a determination from the IRS? _____yes ____no. What are your feelings on this option?
8. Has the IRS audited your organization? _____yes _____no. Would you consider the findings to be _____minimal ______significant?
9. Is determination of independent contractor status an issue within your organization? _____yes _____no. Comments?
10. What is your industry type? ________________________

BUSINESS NONPROFITS: HELPING SMALL BUSINESSES IN NEW ORLEANS SURVIVE KATRINA

Kenneth J. Lacho, University of New Orleans
Don B. Bradley III, University of Central Arkansas
Michael Cusack, University of New Orleans

ABSTRACT

The research gathered for this paper examined how business nonprofits helped small businesses in New Orleans, Louisiana survive the aftermath of Hurricane Katrina. The research chronicles the various aspects of the help provided by business nonprofits and associations to not only its members but to the community at large. The importance of networking and the use of the Internet became vital to the success of these organizations in trying to help the small business community.

These organizations help small businesses find contractors, health permits to reopen their business, small business loan information, as well as trying to help businesses find places for their workers to live or stay.

The largest obstacles for small businesses were lack of employees, insurance and proof of loss. Many of the individuals who needed help could not prove credit worthy for SBA loans. Or, because of lack of proof of loss, were unable to receive insurance settlements if they had any insurance at all. These organizations not only had to provide opportunities for creative financing, but psychological help for the individual small businesses affected. In many cases it was showing that someone cared and was trying to help that made the situation bearable in an almost unbearable situation.

Another problem that the nonprofits and associations had to face was the price for nearly everything skyrocketed and there were few signs that things were about to get better. This created a need to reassure the small businesses owners that everything would be all right.

In times of crisis, this research chronicles the need for small businesses to help each other in a common cause of bringing the community back to economic health.

INTRODUCTION

This paper investigates the role of business nonprofit organizations in helping with the survival and recovery of small businesses in the New Orleans Metropolitan Statistical Area (MSA) from hurricane Katrina.

On August 29, 2005, the most destructive hurricane (Katrina) in the history of the United States hit the City of New Orleans, surrounding parishes and the Mississippi Gulf Coast. Starting as a small easterly wave off the coast of West Africa it developed during late August, the peak of hurricane season. The disturbance became a tropical depression on August 23 and then Tropical Storm Katrina. On August 25, Katrina became a hurricane, passed over South Florida and headed northwest into the Gulf of Mexico. Katrina quickly mushroomed into a Category 4 hurricane. On Sunday August 28 it reached Category 5, packing winds up to 175 mph.

Within 72 hours Katrina had become a monster storm capable of mass destruction as it headed for the Mississippi Coast and New Orleans, a city below sea level. The Big Easy's aging levee system and the loss of protective wetlands made it extremely vulnerable. When Katrina landed just east of New Orleans it was a Category 4 hurricane with winds of 140 mph (CNN Reports, 2005).

Katrina claimed over 1,300 victims. The official cost of damage to the entire Gulf Coast region is estimated to be over $200 billion. Over a million people evacuated inland (CNN Reports, 2005).

The impact was great on the City of New Orleans and the nearby parishes of St. Bernard, Plaquemines and East St. Tammany, all in the New Orleans MSA. Damage from wind and flood waters impacted 434,216 homes; 207,000 so badly they were uninhabitable (Scott & Richardson, 2005; Scott, 2006). Nearby St. Bernard parish sustained a loss of 23,000 homes and 4,000 businesses (Brown, 2005).

Employment remains 32 percent (198,100 jobs) below the pre-Katrina peak. Many schools (especially public schools in Orleans parish) and hospitals remain closed (Scott, 2006). In New Orleans, the small business community was devastated. Some 20,500 small businesses were destroyed, 18,752 of those suffering catastrophic damage (Joyner, et. al., 2006). Employment in the New Orleans MSA is forecasted to be 336,700 jobs in 2006, a decline of 304,290 jobs (Scott & Richardson, 2005).

The impact of Katrina and the subsequent flooding and wind damage was felt in many ways. Entire flooded neighborhoods have been depopulated resulting in a reduced customer base and lost markets. Small businesses related to the tourist trade have faced a decline in tourists. In addition, suppliers to key industries have lost markets (Economic subcommittee, 2006).

At this time no one knows how many businesses will open and how soon. Many businesses cannot open or have to limit their hours of operation due to the shortage of workers. Cash flow drain and the inability to get loans is a problem for many small businesses (Joyner, et.al. 2006).

Restaurants have been hard hit as well. Only 21 percent of all restaurants in the City of New Orleans were open in December, 2005 (McNulty, 2005). The Louisiana Restaurant Association reports that in February, 2006, 56 percent of Jefferson parish retail food establishments, 27 percent for Orleans parish (City of New Orleans) and 37 percent total MSA restaurants have been recertified to open (Hurricane Katrina/Rita News, 2006). Restaurant employment was 55,400 pre-Katrina. December, 2005 employment was 33,200, but employment on the whole remains 40 percent below the August peak.

The problem is that the greater part of the restaurant industry lies in the "bowl," the four parishes inside the levee systems. They experienced devastation due to flooding and wind. Many restaurants either had inadequate or no insurance. The second is the lack of staff due to no places for employees live. Restaurants are limited in the number of days and hours they can be open and in their menu offerings. The third problem is the lack of customers due to depopulation and a decline in tourism (Scott, 2006).

Preliminary findings of a survey of 937 small business located in a 16 mile triangle (including three major business streets in New Orleans) found that: (1) local businesses are coming back and in greater numbers than national chains, and (2) primary goods and service outlets are not necessarily opening before stores that sell luxury items. Levee protection was ranked as the number one problem, followed by lack of customer base, lack of employees and communications (Calder, 2006). The lack of housing contributes to the shortage of workers. Some employees (and business owners) commute 70 miles one way to work from Baton Rouge or communities north of Lake Ponchartrain. A free bus service is available from Baton Rouge to New Orleans and back. The FEMA trailer program has been less than successful. In fact, one small business owner had a FEMA trailer stolen from the lot next to his business.

PURPOSE

The foregoing description of the devastation of the New Orleans MSA reflects the need to help the population and the business community recover. Assistance has come from all levels of government, private organizations and churches. This paper examines the efforts of nonprofit business organizations in the New Orleans MSA to assist in the survival and recovery of its members, primarily small business.

RESEARCH METHODOLOGY

Presidents, managers, and directors of eight nonprofit business organizations and two economic development agencies were interviewed in person or by telephone. Secondary sources such as e-mail messages, fliers, newsletters and brochures of these organizations were examined.

FINDINGS

Jefferson Parish Chamber of Commerce

The Jefferson Parish Chamber of Commerce (1,000 plus members) partnered with the Jefferson Parish Economic Development Commission (JEDCO) and the Jefferson Business Council on a number of activities. During September and October, 2005 funding was provided for four public forums for business disaster victims. Topics covered were insurance (put on with the State Insurance Commission), labor issues (with the Louisiana Department of Labor), the New Orleans Airport, and finances with the U.S. Small Business Administration and bankers.

During November and December four job fairs matching job openings and prospective employees were held in cooperation with the Jefferson Parish Workforce Connection Business Center. Also in November, 2005, the Chamber sponsored free one-on-one small business consultations for small business owners with International Profit Associates Consultants, the largest privately-held business development company for small and medium sized business in North America. In March, 2006, the Chamber presented a workshop with the Workforce Connection Business Center on "Workforce Training."

The Chamber, in partnership with BellSouth and ATMOS Energy, is offering a Small Business Recovery Hotline open to any business in Jefferson parish. Hotline callers are referred to one of the Business Recovery Centers set up by the Chamber with JEDCO and the Jefferson Business Council. Centers are located on the West Bank and East Bank of the Mississippi River. The Center offers information and advice from the SBA, Loyola SBDC, JEDCO, Jefferson Parish Workforce Connections and the Louisiana Department of Labor (Chamber responded, 2005).

Notices about meetings of other organizations were posted on the website and sent to members via e-mail.

Turnaround Management Association (TMA) New Orleans Chapter

The New Orleans MSA faces a turnaround. So do many MSA small businesses. The TMA of New Orleans presented two one-day small business recovery workshops in December, 2005 one in Baton Rouge and one in Jefferson parish. The former was cosponsored with the LSU-SBDC, the latter with JEDCO. Papers and articles on disaster recovery were posted on the Internet for members and the public. Offers of TMA assistance were presented on the web (a blog). This has not been successful. On March 30, a workshop was conducted on troubled loan accounts.

New Orleans Metropolitan Convention & Visitors Bureau, Inc. (NOMCVB)

There were a number of actions taken by the NOMCVB to assist its members. During the early months of recovery, several meetings were held to update members on the status of the industry, conventions, and tourism. The lack of meeting space for large groups made this a difficult task. Dues were reduced by 50 percent. Days after the storm, sales representatives were out across the U.S. visiting with clients about upcoming conventions. The president, Mr. Steve Perry, was active in commissions formed to help the city recover. NOMCVB worked with the French Quarter Merchants Association to clean up the French Quarter, essentially a trash and litter abatement program.

During March, 2006 focus group meetings were held by industry segment. The question was how can the NOMCVB help businesses in these segments? The segments included were the French Quarter, restaurants, transportation companies, and destination companies.

Small group breakfast/coffee meetings will be held on a quarterly basis. Members in attendance will have the opportunity to interact with NOMCVB division heads, e.g., convention sales.

Greater New Orleans Hotel & Lodging Association (GNOHLA)

The GNOHLA has 220 members, 102 hotels and 118 allied firms. Ninety percent are small businesses by SBA standards.

The organization took several actions in the post-Katrina era. Almost daily, e-mail alerts were sent out on updates received from disaster relief agencies, and federal, state, and local government agencies regarding issues that directly affected the industry. In a similar way, the GNOHLA served as one of several clearing houses for media, business, governmental, and individual letters/e-mails/faxes about what was going on in post-Katrina. A FREE Hospitality Employment web site was created that was available to any employers in the region to post their job openings so any potential employee could view them.

A cooperative effort was carried out with the State Office of Tourism to secure and publicize the availability of a ship that was docked at the port of New Orleans for users as temporary housing for hospitality industry employees who had nowhere to stay but were available to work.

Assistance was provided to the U.S. Small Business Administration in coordinating several SBA Disaster and "Go" Loan Processing sessions and seminars.

Last, the GNOHLA partnered with several agencies during the initial recovery periods to present seminars on procuring housing for employees. These were the SBA, City of New Orleans, New Orleans Metropolitan Convention & Visitors Bureau, the Louisiana Restaurant Association, and the New Orleans Tourism Marketing Corporation.

Louisiana Restaurant Association LRA

The restaurant industry in Louisiana is the state's largest private employer. Restaurants generate $4.8 billion in annual sales. The LRA has 7,000 members; its actions in the post-Katrina era are considered below.

The LRA communicated (e-mail) with members to advise them about suppliers of food, services (e.g., laundry) and insurance issues. For example, in October, 2005 a free seminar was conducted by consultants and attorneys to help businesses document and quantify losses related to business interruption claims. The LRA was a key link with members on insurance matters.

A restaurant employee's relief fund was established to help pay the expenses of those returning to the area. Fund raising events were held to raise money.

The LRA internally funds its own employee workman's compensation program. This self-insured fund is worth $760 million statewide. The association was able to keep workman's compensation checks coming to employees drawing such benefits.

Efforts were made in getting housing for employees by working with the Louisiana Department of Economic Development and FEMA. The LRA worked with the Housing Taskforce of the New Orleans Chamber of Commerce and GNO, Inc. (an economic development agency) on this matter as well.

Two job fairs were held for members in cooperation with the Louisiana Department of Labor. Also, on the labor front, the National Restaurant Association established a jobs board. This is a resource for restaurants to use when they start rebuilding.

A list of suppliers who were able to supply food to area restaurants was provided to members. Food supply, however, is not an issue; getting employees housing is, however.

Last, the LRA worked with the state health department inspectors to develop procedures to help restaurants upon reopening.

Louisiana Department of Economic Development (LED)

Although not a nonprofit business association, the LED needs to be noted because of its collaboration with the nonprofits. The state Department of Economic Development has established a program which provides free counseling services to small businesses located in areas hard hit by hurricanes Katrina and Rita (Southwest Louisiana). The services are provided at eight centers located in Baton Rouge, Houma, Lake Charles, and the New Orleans MSA. Funding is provided by the Economic Development Agency of the U.S. Commerce Department. The centers are staffed by private volunteer consultants, economic development professionals, federal and state representatives, and local economic developers. Web sites and telephone numbers for interested parties are provided. Collaboration is with chambers in West St. Tammany, Jefferson, and the Lake Charles/Southwest Region (Agency to offer, 2006). In addition, the department has partnered with the

Louisiana Technology Council to develop a business recovery and office incubator center in the New Orleans MSA.

The LED also sponsored a contracting matchmaker workshop in February, 2006 in Mandeville, La., on the Northshore. A cosponsoring agency was the Southwestern Louisiana University SBDC. Other area organizations cosponsoring the event were the West St. Tammany Chamber of Commerce and government agencies such as the SBA (Contracting Workshop, 2006).

St. Tammany West Chamber of Commerce, Covington, La.

The St. Tammany West Chamber of Commerce (STWC) is located in Covington, La., north of Lake Ponchartrain. It has some 1,060 members. The area sustained some flooding along the lake and wind damage.

The Chamber created an on-line resource center as soon as power was restored in mid September, 2005. Hard copies of all recovery information and forms on the website were available at Chamber offices for those without internet access. The site contained information on available grants, loans, and services. Lists of available commercial properties were uploaded regularly. Links to job listing sites, member realtors and social services providers were added.

Free workshops were held daily during October, 2005 on SBA loan applications. Coordination was with the Southeastern Louisiana University SBDC.

The St. Tammany West Chamber of Commerce is a participant in the LED network of business counseling centers. Free counseling sessions are held Wednesdays and Fridays at the Chamber office. The sessions are designed to provide an in-depth review of a firm's business plan and provide advice on financial, insurance and tax issues.

The Chamber has received 994 walk-in visitors during the post-Katrina period. Some 596 recovery-related phone calls were received. There were 315 on-line inquiries and 960,391 post-Katrina websites hits (West St. Tammany Chamber Annual Report, 2005).

Hispanic Chamber of Commerce (HCCL)

The HCCL conducted three free workshops during October 2005. While there are many helpful programs available to small businesses, the missing component for Hispanic businesses is usually the language. Consequently, the above noted workshops were bilingual. Topics included disaster relief in general (e.g., permits, legalities). Presentations were made by FEMA, the SBA, JEDCO, Southeastern Louisiana University SBDC and the American Red Cross.

The HCCL provides one-on-one business counseling sessions in Spanish by experienced business counselors. Sessions are 30-45 minutes on Fridays. The UNO SBCD is a cooperating agency on this service.

The Hispanic Business Resources Technology Center (also known as the Hispanic Business Center) is being created to address the post-Katrina crisis situation in the New Orleans MSA affecting the Hispanic Community. The HCCL and the Southeastern Louisiana University (SLU) College of Business through its Latin Business & Development Initiative have dedicated staff and resources to develop programs to help Hispanics recover and rebuild their lives. The Catholic Charities Archdiocese of New Orleans handles the social needs of Hispanic families.

Services provided by the Hispanic Business Center include business startup and expansion courses and counseling, tax assistance, workforce development, English as a second language, computer technology, and help in assessing and processing disaster relief forms. Programs and workshops will be presented in areas outside the center itself which is located at a site in suburban Kenner, La. The U.S. Hispanic Chamber of Commerce provided seed money to develop the Center.

Better Business Bureau of New Orleans (BBB)

The Better Business Bureau of New Orleans had 4,000 members prior to Katrina. Membership post-Katrina is estimated to be about one-half that number. Some 90 percent of the members are in small business according to the SBA definition of a small business. One of the staff members had evacuated to Arkansas, but during the first two weeks after the storm produced television and radio announcements warning consumers and commercial businesses about contractor and other scams. These were run on New Orleans MSA electronic media.

BBB members were advised to check out contractors. The intent was to push users from bad contractors to good (honest) ones, those who had proper insurance and licenses.

A cooperative effort was carried out with the Slidell Chamber of Commerce and police department to distribute materials related to how to select a contractor. Cooperative advertising was carried out with WWL-TV in New Orleans. BBB members sponsored a TV spot and as a result, got exposure. Members of the BBB were offered the opportunity to use the BBB Torch logo on letterheads and business cards. Essentially, the BBB and its website served as an information bureau for consumers and small businesses, members and nonmembers alike.

The Louisiana Technology Council (LTC)

The LTC's mission is to help with the technological development of individuals and member organizations, to provide events, programs, and organization support that contribute to the competitiveness and growth of the area. Prior to Katrina the LTC had 430 members; after Katrina, 330 members, 98 percent being small business. Prior to Katrina the LTC had a president and two staff members. After Katrina, both staff members left.

During September and October, 2005 the LTC provided information (via a website) to its members on employees, housing, money, and working with the SBA. During November a recovery plan for the LTC was developed.

Funding was considered to be of great importance. Membership dues and special events provided revenues pre-Katrina. Starting in November other revenue generating opportunities were sought out. In addition to donations, LTC created a Web Fund Raising site to allow people or organizations to contribute funds to the LTC.

The LTC president made various fund raising presentations to various technology councils across the U.S. Special presentations were made in Denver, Pittsburg and Portland, Maine to raise funds. Several technology councils in the U.S. have held fund raising events for the LTC. A new schedule of events was developed, a major one being on Homeland Security which was held in January, 2006. Grants and other appropriations have been researched.

A Technology Business Recovery/Incubator Center has been recently established. The purpose of the Center is to help displaced Louisiana companies recover from Katrina by providing them with office space and technology service and support at little cost. Firms on an interim basis will use the center until they can reestablish their business operations. Over time, the LTC will transform this center to an incubator location to allow entrepreneurs to develop their ideas into commercialized products.

The LTC has recently received a donation from the Pittsburg Technology Council of twenty IBM Think Pad laptop computers for the Center. Microsoft has committed to donate all of the licensed software required to operate each laptop computer and Cox Business Services has agreed to donate internet and phone service to the facility at no cost. Waldemar S. Nelson Co. provides office furnishings.

The center can accommodate up to 13 companies in its 1,500-square-foot space located next to the LTC at 1215 Prytania Street, Suite 329, in New Orleans and is available now. Each company located at the center will pay a small fee for the space and services provided. The LTC also expects to provide tech support and business-growth services to participants.

As part of the recovery process, the LTC is establishing a Business Mentorship Program which will be first piloted with the Colorado Software and Internet Association. A survey will be created where Louisiana displaced businesses can fill out their needs and then firms across the country will be able to adopt them to help with these needs, which can include software, hardware, loaned executives, money, business recovery planning and business-to-business workflow.

LTC is seeking five (5) companies for its monthly (March) Tech Tuesday meeting. Each company chosen is expected to present to LTC members and address the following areas: based on your business planning and recovery pre-Katrina, how has your company grown? What do you attribute your success to? What challenges did you have to overcome? What kind of attitude did you take? How did your thinking process change and why? What resources did you use to help move your company forward? How did government help, if at all? What specific help did you get from other organizations? Also, each company chosen will be a sponsor for Tech Tuesday for $750.00. This event provides exposure for presenters and serves as a fund raiser.

In summary, the LTC approach is to further economic development in the area using technology and to be very proactive in its strategy.

Jefferson Parish Economic Development Commission (JEDCO)

JEDCO is an independent, yet complementary arm of Jefferson parish government. Its main objective is to attract, grow and create new businesses in Jefferson Parish. Areas of service include business financing, an incubator program, business outreach (job retention and expansion, business attraction, and tax incentive programs), and economic development services.

JEDCO has been involved in a number of initiatives to assist small businesses recover from Hurricane Katrina. Since September, 2005 JEDCO has assisted over 1,600 businesses providing support and business counseling. Additionally, JEDCO has hosted several "Back to Business" forums, workshops and seminars during the months right after the storm. JEDCO worked with the New Orleans Turnaround Management Association (described above) in presenting a one-day workshop in December, 2005 on disaster recovery. Post-Katrina action workshops and seminars were conducted during March, 2005 in cooperation with the Loyola University SBDC.

Business Recovery Centers have been established on the East and West banks of Jefferson Parish. These are cosponsored with the Louisiana Department of Economic Development (See above). Free counseling is provided in these centers to Jefferson Parish companies that need post-Katrina help. Small business owners meet one-on-one for one hour with consultants.

JEDCO's web page is the site of many announcements related to post-Katrina help and assistance with professional business counselors.

DISCUSSION

Prior to Katrina, nonprofits served a valuable service to their members and the community, be they in the arts, faith-based or business. Business nonprofits (trade associations) provided educational and networking opportunities. According to a study of the Louisiana Association of Nonprofit Organizations, 70 percent of nonprofits in Louisiana were in the affected parishes. In 2004, there were 2,324 nonprofits in the New Orleans MSA; only 912 had an annual budget of $25,000 or higher (Strachan, 2006). Some 9.7 percent of employed persons in New Orleans worked for nonprofits.

The findings show that the business nonprofits in this study made extensive use of e-mail in communicating with their members, as well as holding workshops, etc. on disaster relief topics such as insurance, SBA loan programs, and other options to get help. The website served as a community newspaper alerting the members to news of interest to them. Employee matters were of importance, especially hiring and finding housing for them.

Cooperation or partnering on events among the nonprofits was used. In addition, we see nonprofits working with government economic development agencies such as the SBA, JEDCO, the LED, Southeastern Louisiana University and area SBDCs.

Four of the nonprofit organizations were really strapped for funds. These were the HCCL, Jefferson Chamber of Commerce, the BBB and the LTC. Personnel were laid off and volunteer help sought out. Some directors took no pay or a cut in pay. The LTC took a very proactive additional approach, aggressively seeking out funding from national sources and grants. All fund raising events were cancelled for the fall of 2005. The director toured technology councils in the U.S. seeking assistance as well as getting equipment and service help from technology companies.

Some nonprofits in New Orleans have also gone national in seeking out funding. The Preservation Resource Center and the Contemporary Arts Center held events in New York City. Idea Village, a local organization which assists businesses to grow, is planning fund-raising road shows to interest a national network of expatriates who want to get involved and support the rebuilding of New Orleans. The group is targeting Atlanta, Dallas, Boston, Houston and San Francisco (Strachan, 2006). Ironically, the economic hardship brought on by the hurricane now allows many groups to apply for national grants that were not available to them before.

As the information was gathered for this research, it became very evident that networking within nonprofits, associations, local government agencies, neighborhood communities, and family were more important in starting the recovery process than the programs from many state and federal government agencies. It also became evident that the Internet as a tool of communications was the most important element to get the word out to the business community. One of the biggest challenges small businesses faced was that in the early months after Katrina the mail service, telephone service and even cell phone service was either non-existent or unreliable.

Some demographic problems that businesses faced were that two-thirds of the residents of New Orleans proper were gone, a quarter of the metro area's businesses today remain shattered, and nearly one of every five persons eligible to work is unemployed.

CONCLUSION

The rebuilding of New Orleans will be done by the local people themselves through non-profit organizations and associations. Most of this work will be done by volunteers who have a passion not only for the type of business or community area they represent, but a passion to make New Orleans live again. It is truly amazing how businesses have helped businesses and neighbors have helped neighbors in this time of need. The importance of networking is a key thread to the success of the rebuilding of New Orleans. From a technology point of view, the Internet became the most valuable tool that these entities had to work with, because the mail and telephones were sporadic or non-existent. Another important element was how the various groups pulled together to help the small businesses in need. Unfortunately, some of these entities have not worked that closely together in the pre-Katrina era; however, it is hoped that these organizations can build on their current cooperation and sharing.

REFERENCES

Agencies that offer free counseling for businesses in storm stricken areas (2006, February 14). *The Advocate*, D 1.2.

Brown, M.(2005, Dec. 25). Plaquemines, St. Bernard start anew. *The Times Picayune*, 1.

Calder, C. (2006, Feb.2). Survey snapshot of N.O. businesses. *The Advocate*, 1A, 4A.

Chamber responded quickly for members. (2005, December). *Connections*, 1, 10.

CNN Reports (2005). *Katrina state of emergency*. Kansas City, MO: Andrews McMeel Publishing.

Contracting workshop offers tips, matchmaking. (2006, February 16). *The Advocate*, 20.

Joyner, B. Blake, C., Stern, L., Logan J., & Mancuso, L.. (2006, Jan.). *Rebuilding the City of New Orleans*. Paper presented at the meeting of USASBE.

McNulty, I. (2006, January 3). Reopening Resolutions. *Gambit*, 51.

St. Tammany West Chamber Annual Report (2005). *Business recovery center*, Author, 3.

Scott, L. C. (2006). *Advancing in the aftermath: Tracking the recovery from Katrina and Rita*. Baton Rouge, La. Author.

Scott, L. & Richardson, J.. (Nov., 2005) *The Louisiana Economic Outlook: 2006 and 2007*, (24th annual edition). Baton Rouge, La.: Division of Economic Development and Forecasting, E. J. Ourso College of Business Administration, Louisiana State University.

Staff. (2006, Feb. 24). Hurricane Katrina/Rita news. The Louisiana Restaurant Association Restaurant Report.

Strachan, S. L. (2006, February). The state of fund-raising. *St. Charles Avenue*, pp. 24-26.

DISASTER LOANS: DOES PREPAREDNESS MATTER?

Robert Carton, Western Carolina University
Frank Lockwood, Western Carolina University
William Richmond, Western Carolina University

ABSTRACT

It is generally accepted that being prepared for a disaster is simply good business practice and essential for reestablishing the business after an interruption. This research addresses the question of whether being prepared with backup operating and financial records materially impacts the ability of small businesses to receive state or federally-backed disaster recovery loans to reopen their establishments. We conclude that obtaining disaster recovery loans and the time from application to funding was more a function of the policies and procedures of the state and federal governments, than the preparedness of the affected small businesses. The use of a consultative approach by the lending agency was much more effective than a traditional loan officer approach.

INTRODUCTION

All businesses are subject to business interruptions. They are caused by factors that affect as few as a single company, such as a fire, or factors that can affect an entire region, such as hurricanes. It is generally accepted that being prepared for a disaster is simply good business practice and essential for reestablishing the business after an interruption. This preparedness includes plans for restoring or replacing critical company resources and capabilities be they human, physical, or financial. Natural disasters create particularly challenging issues for small businesses and their disaster preparedness plans. Complicating recovery efforts after a natural disaster is the failure of small businesses to obtain adequate insurance to recover financially. Recognizing this circumstance, federal and state governments have created disaster recovery loan programs to provide capital for small businesses to reopen. This research examines a group of 88 small businesses located along the rivers in the area surrounding Asheville, North Carolina that received disaster recovery loans and considers whether having a disaster recovery plan and/or financial and operating records mattered in disaster loan approval and funding.

The issue of disaster preparedness has primarily been addressed in both scholarly literature and popular articles that describe the best practices for developing recovery programs at large companies and for information technology departments. Very little of that literature addresses the needs and issues of small businesses. The little that does exist focuses on the importance of planning (Bielski 2002, La Fazia, Ames & Koch 2004, Tiller 1994) and on what a disaster recovery plan should contain (Bielski 2002, Kinkade 2005, La Fazia, Ames & Koch 2004, Pofcher 2005, Scarinci 2002, Tiller 1994).

Prior literature on pre-planning for natural disasters primarily comes from the Information Technology (IT). Grant and Leibs (2006) surveyed 1,286 managers responsible for business contingency plans and found the vast majority of those responding were IT managers, technology staffers, or chief information officers. Their responses indicated that large companies focus was on establishing hot backup sites, located sufficiently far from the primary IT operations so that they would not be impacted by the same natural disaster. This study did not explicitly address the case of small businesses that do not have dedicated risk managers or IT staff.

The Florida Bureau of Recovery and Mitigation, part of the Florida Division of Emergency Management, conducted a survey of 230 small businesses in Duval County, Jacksonville, Florida that analyzed the steps taken to mitigate the affects of a natural disaster (Yoshida 2005). The survey focused on three mitigation factors: business continuity planning; structural hazard mitigation; and purchase of disaster insurance. The study found three primary reasons small businesses do not take steps to mitigate the effects of a natural disaster: (1) the type of business; (2) access to expert counseling; and (3) the perceived exposure on the part of the small business owner to the location of the business.

Runyan (2006) interviewed business owners in five Gulf Coast counties affected by Hurricane Katrina in 2005. The anecdotal information gathered from these interviews found small businesses: failed to have a recovery plan; were vulnerable to interruptions in cash flow; lacked necessary capital to recover from a disaster; were frustrated in reopening due to major disruptions to infrastructure (roads, electricity, etc.); and were unsuccessful in dealing with federal assistance programs offered by the U.S. Small Business Administration.

It is the general consensus from those articles that discussed small business and natural disasters that most small businesses were ill-prepared. However, nothing in the literature was found to address what a business should do when disaster strikes and the small business either did not have a disaster recovery plan or the disaster was so extensive that the disaster recovery plan failed.

Governmental Programs that Provide Business Capital after Natural Disasters

There is an underlying assumption that business interruptions are individualized to a company—the disaster happens solely to the company. Risk management focuses on insurance to replace property, plant, equipment, and inventory, while contingency plans focus on relocating facilities and operations including information technology and communication systems, recreating product and/or service delivery, reestablishing sales and marketing functions, and restoring financial and administrative functions. Commercial risk management products and services deal with these circumstances. However they do not deal with a general collapse of society, markets, and infrastructure. That is the responsibility of local, state, and federal governmental agencies.

Restoring business as usual is not possible when an entire region is affected by a natural disaster. The issues faced by businesses in this situation are more akin to starting a new venture than recovering from a single business interruption. All of the assets of the business may have been lost in the disaster including facilities, inventories, and most importantly, employees may have been displaced and lost temporarily or even permanently if they choose to relocate. Customers may be in the process of recovering, leaving no local demand. The ability to ship outside the immediate region may be disrupted due to a damaged infrastructure including impassable roads, inoperable marine terminals, damaged airfreight facilities, and shortages of essential commodities such as fuel and power. Suppliers may be out of business or have no readily available inventory to provide the critical inputs for the business. Employees may have evacuated and upon their return, they may be consumed with recovering their personal lives. In essence, the business involved in a regional disaster may have to develop an entirely new business plan including target markets, operating strategy, staffing plans, and attracting new financial resources.

Both Federal and State government programs exist to assist small businesses obtain capital after a widespread disaster. The Federal programs are administered by the SBA. State programs vary in format and function from state-to-state. The one common denominator is the programs are intended to get businesses functioning as quickly as possible to provide vitally need products and services as well as reestablishing the employment base by providing capital in the form of low interest loans with deferred repayment schedules. As with any lending program, the applicant for a loan must demonstrate a need for the funds and the ability to repay the loan. Logically, a business that has properly prepared for a disaster will have backups of historical financial records and a business plan for the business going forward. Practically, when a natural disaster completely destroys a business as well as the local accountants' and attorneys' offices, as well as the local banks and the surrounding residential communities, original and backup copies of financial records may simply not exist. Additionally, most insurance policies exclude natural disasters such as floods and earthquakes meaning that the losses sustained by the business will not be reimbursed, even if records did exist to substantiate what was lost. The net result is businesses that do not have historical records, collateral, or equity apply for disaster loans.

The SBA disaster loan programs have been soundly criticized both in Congress and in the popular press as ineffective (Seck, 2006). The main reasons cited were the overly bureaucratic approach regarding the loan application process and the inability of the SBA to handle the number of loan requests. Since SBA loans are based on the ability to repay, the application must include three years of tax returns and other documentation that demonstrate the business has the income potential to pay interest and repay principal. According to some reports, incomplete applications are stacked into piles awaiting completion putting potential borrowers in "SBA limbo." The SBA had received approximately 30,000 loan applications after Hurricanes Katrina (August 24, 2005) and Rita (September 24, 2005) left the Gulf Coast in shambles. According to a report in Business Week (Klein, 2005) the SBA had managed to process only 9% of the applications, approving 949 and declining 1,835. And, these results were after the SBA relaxed the requirement for applicants to provide their last three years' monthly sales analysis or a title or record search as well as waiving the need to include three years of business tax returns.

To more directly address the economic needs of the regions affected by a natural disaster, the State of North Carolina established the North Carolina Recovery and Development Fund (READE). READE is a program to not only make disaster loans to small business, but to also provide them with business counseling to help them be successful in reestablishing their businesses in a dynamic and challenging economic environment. The READE program approach is philosophically different than the SBA in that the SBA approach uses bank lending procedures while the READE uses a consultative approach. The State of North Carolina believes that the approach adopted by the READE program was more likely to result in timely disaster loan approvals and superior loan repayments than the loan officer approach.

The reports of unprocessed loans due to lack of financial information begs the question, does being prepared with backup operating and financial records materially impact the ability of small businesses to receive state or federally-backed disaster recovery loans to reopen their establishments? Further, do the loan processes and procedures impact the likelihood and timeliness of disaster loan approvals? This research examines 88 small businesses in Western North Carolina that applied for disaster recovery loans from the READE program, and in some cases from the SBA program as well, to investigate these questions.

METHODS

We examined the issues surrounding disaster recovery funding using a private data set provided by the North Carolina Small Business Development and Technology Center (SBTDC). The SBTDC administered the READE program in cooperation with the Department of Commerce that was initiated after Hurricane Floyd struck eastern North Carolina in 1999 (READE1). The READE2 program was offered to small businesses affected by the Hurricanes Frances and Ivan in the fall of 2004. Businesses affected by flooding from these hurricanes could apply for disaster relief loans to cover physical damage, economic damage and debt consolidation. The loan process included completing a loan application and meeting with a loan counselor from the SBTDC. It was the responsibility of the loan counselor to help the applicant complete the application, to advise them on the type and format of supporting data to provide, and to prescreen applicants for qualification for the program. In this capacity, the counselor was an advisor, an advocate, and a gatekeeper for the READE program.

Data was gathered from the loan applications for all of the firms that were approved for loans. Further, data was gathered and coded from reviews of the case notes for the firms that either did not complete the loan application or whose loan application was turned down. In most cases, the clients withdrew early in the process either because they were unwilling to provide the required documentation or were advised by the loan counselor that they would not be successful in obtaining a loan.

At the start of the initial consulting session, the client provided basic demographic information about the business, including: the business owner's race, gender, veteran status, and disability status, as well as the date the business was started, the type of business, and its organizational structure (e.g., sole proprietorship). They then completed the loan application. Frequently, this took multiple meetings, but the loan application package included both an application and supporting documentation. The application specifies such information as the amount of damage, other sources of funds, such as insurance, the amount of the loan being applied and how the funds will be used. The supporting documentation included verification of the existence of physical loss, verification of the value of physical loss, and verification of the value of economic loss. All applicants were required to provide copies of their federal income tax returns. These documents were used to verify business profitability, which was used both to verify economic loss and the client's ability to repay the loan.

Our specific concern was with how the client verified their loss claims. Based on the documentation in the application file, we coded 20 different variables: the documentation used to verify the existence of physical loss; the documentation used to verify the value of physical loss; the documentation used to verify the value of economic loss and the source of the client's federal tax returns.

To document the existence of physical loss, clients used four alternatives. In most cases (54 out of 80), clients took pictures of the damage. The pictures were taken after the floods and showed damage to the physical plant, such as washed away picnic areas or loss of inventory. In the case of the loss of inventory, the pictures showed that there was a loss, but did not show each and every item lost. In one case, the client was a nursery. The pictures showed the plants growing several miles from the nursery. Alternatives to pictures include physical inspection by someone other than the client, historical records of the assets or the client's memory. In the case of the client's memory, there was no outside verification that a loss occurred. In some cases, the clients used multiple approaches to document the existence of physical loss.

To document the value of the physical loss, the clients used six alternatives. The most common approach to document the loss was providing receipts for the replaced items (39 out of 80). These receipts were included as part of the file documentation. We did not verify that the value of the receipts equaled the value of the physical loss claimed, but that was a required procedure for the counselor. The use of receipts implies that they had already fixed the damage incurred. Since the hurricanes hit in September 2004 and the loan program did not occur until April 2005, it is not surprising that those businesses that could recover their physical losses did so. The other alternatives included historical records (typically inventory records from an accounting system), insurance claims (the documentation used to verify the loss to the insurance company was not documented), memory (typically a list of items lost with the client's estimate of the value of the loss), vendor estimate (usually of the cost to fix the physical plant, replace the machinery or replace the inventory), and tax appraisal (for loss of physical plant). In some cases, the clients used multiple approaches to document the value of physical loss.

To document the value of economic loss, the client had to show what their sales would have been without the hurricanes. The estimated cost of goods sold was then deducted to calculate the economic loss. The key factors here were documenting the monthly revenue and the cost of goods sold. In most cases (47 out of 65), to document the sales for the economic loss, the client provided records. For a few of these cases, the records were included in the file. Types of records included were sales records from an accounting system and/or copies of sales tax forms (from their own records, their accountant or from the state government). When the records were not included in the files, we assumed the client had detailed monthly sales records if the level of detail indicated this (e.g., differing monthly sales figures down to the penny). This classification was supported by interviews with the loan counselors. In other cases, the client relied on their memory, supplemented by their federal tax returns, which showed their annual sales. In these cases, the loan consultant assumed that the client's annual sales were evenly distributed across each month.

Finally, all loan applicants were required to provide copies of their federal tax returns for the preceding three years (2002, 2003, and 2004). The tax returns were classified as being their own copy, their accountant's copy or a copy requested from the IRS. In some cases, the different years' returns were from different sources. Table 1 provides descriptive statistics for the data.

DISCUSSION

The correlations among the variables are shown in Table 2. In general, the correlations among the variables were very low. In a few cases, correlations were high (in absolute value) because the variables are part of a set, such as the variables for business type and organizational structure (business types 81 and 44 have a correlation of -.65; organizational types 1 and 3 have a correlation of -.68). Other high correlations were expected, such as the correlations between the amount of the loan applied for, the amount of damage incurred, the amount of loan received and the amounts of other sources of disaster funds). The only correlations of interest are:

- The relationship between start year and amount of damage
- Other funding and historical records to document the existence of physical loss
- To document the existence of physical loss, pictures and inspections were typically used with another method, but not with each other.
- Replacement receipts were also usually associated with another method of showing the value of the loss
- The sources of tax returns are correlated.

Table 1: Descriptive Statistics for Explanatory Variables

Relevant Topic	Variable	Variable Definition	Number	Minimum	Maximum	Average	Std Dev
Demographics	Race	Owner is white	85				
	Gender	Business is more than 49% female owned	48				
	Veteran	Owner is a veteran	14				
	Disability	Owner is disabled	0				
	Start	Year that the business was started	88	1946	2004	1991	13
	Type	Other Services	44				
	Structure	Sole Proprietorship	43				
Damage	Physical	Amount of physical damage recorded	80	321	2029532	111186	289400
	Economic	Amount of economic damage recorded	65	579	488924	46132	76902
	Consolidation	Amount of debt consolidation requested	17	1342	2518456	172182	605078
Loan	Applied		88	10000	402768	76360	74349
	Received		88	10000	335254	71360	60474

Table 1: Descriptive Statistics for Explanatory Variables

Relevant Topic	Variable	Variable Definition	Number	Minimum	Maximum	Average	Std Dev
Funds	SBA-Denied		20				
	SBA-Withdrawn		10				
	SBA-Disbursed		15	10,000	658,800	186,980	196757
	Insurance		13	2094	1238772	202458	372743
	Other		2	2470	3000	2735	375
Documentation	Physical Loss		Inspection	Picture	Historical Record	Memory	Multiple
			10	54	15	23	22
	Physical Loss Value	Other	Vendor Estimate	Replacement Receipts	Record	Memory	Multiple
		9	17	39	25	31	35
	Economic Loss			Other	Record	Memory	Multiple
				3	49	22	8
	Tax Returns		None	Own	CPA	Govt.	Multiple
			5	58	38	7	18

Many of the companies in the study lost their homes along with their businesses. Consequently, backup documentation, such as tax returns or electronic backups of computer data, was lost to the same storm that destroyed the business and its records. Relying on local service providers such as accountants and bankers for maintaining backup information frequently proved to be ineffective because those offices were destroyed as well.

Having data or not having data did not affect getting a disaster recovery loan. The only reason we have been able to identify for not receiving a loan was the inability to pay. The state of North Carolina's definition or evaluation of a business's ability to repay the loan was much more lenient than the SBA. Of the 46 businesses that applied for an SBA loan, 20 were denied the loan, but the READE2 program approved a loan.

Almost one-third of the businesses with physical damage could not document the existence of the damage, except through their own statement of loss. This, however, did not prevent them from obtaining a recovery loan. Almost 40% of the businesses owners used their memory to document all or part of the value of their physical loss.

Table 2: Correlations Among Explanatory Variable

		4	8	9	10	12	15	16	17	18	19	20	22	23	24	25	26	27	28	29	31	33	41	57
StartYear	4	1.0																						
Bus Type Other	8		1.0																					
Bus Type 81	9		0.65	1.0																				
Bus Org l	10				1.0																			
Bus Org Other	12				-0.68	1.0																		
Loan Amt	15	-0.64					1.0																	
Physical Damage Amt	16	-0.60					0.87	1.0																
Economic Damage Amt	17						0.61	0.59	1.0															
Debt Consolidation	18						0.65	0.75	0.71	1.0														
Total Actual Damage	19	-0.59					0.81	0.93	0.76	0.94	1.0													
Loan Amt Received	20	-0.64					0.95	0.83	0.62	0.72	0.83	1.0												
Applied for SBA	22												1.0											
SBA Declined	23												0.52	1.0										
SBA WithDrawn	24														1.0									
SBA Disbursed	25															1.0								
SBA Amt	26									0.55	0.56					0.60	1.0							
Insurance Amt	27	-0.50					0.71	0.87		0.51	0.73	0.65						1.0						
Other Amt	28																		1.0					
Other Funding	29	-0.52					0.74	0.87	0.55	0.64	0.81	0.71					0.73	0.88		1.0				
Picture	31																				1.0			
Memory	33																				-0.72	1.0		
ELV Other	41																						1.0	
UoF Moving	57																						0.57	1.0

One-third of businesses with economic loss, could not document their monthly sales (other than saying they were one-twelfth of their annual sales), which was the basis for determining economic loss. Almost one-half of the businesses were unable to provide copies of their federal income tax returns without retrieving them from their tax preparer or the IRS. Given this lack of documentation, it could easily be understood if the READE 2 program declined the loan. In fact, most of the firms that applied for an SBA loan prior to applying for the READE 2 loan were turned down by SBA. However, by working closely with the SBTDC counselors, applicants were able to get approval in almost every case based upon expected future cash flows, supported by recovered financial records and knowledge of the local market conditions.

The findings of this study are subject to several limitations. First, the sample was drawn from a single jurisdiction in western North Carolina that was subject to a common natural disaster. Second, the loan files examined were prepared by a single agency, the North Carolina SBTDC. Third, there was incomplete information on applicants or potential applicants that did not obtain loans. Information on those cases was gathered anecdotally from interviews with loan counselors and from unprocessed files. To address some of these limitations, loan counselors that participated in other disaster funding programs in North Carolina and in the disaster loan programs in Mississippi after hurricane Katrina were interviewed. Consistently, their observations confirmed the findings of this study.

CONCLUSIONS

This lack of documentation did not prevent the businesses from receiving disaster aid. This implies that the disaster recover literature is wrong. Disaster recovery planning needs to put less emphasis on large scale disasters and give more weight to smaller, more localized disasters. Given the tendency of the state and federal governments to rescue businesses when a natural disaster occurs, businesses do not need the same level of planning and preparation as they do for disasters that will strike only their business. For businesses that serve a local community, large scale disasters so profoundly affect the economy that a rapid return to operation may be counterproductive. Operations should resume as infrastructure is restored and economic activity resumes. Preparing for a large scale disaster is generally not possible for small businesses that rely on providers in the local area for financial services and resupply, as those businesses may also be affected. Further, the disruption to the local area can result in the dislocation of a company's customer base. The question of the proper timing of the reopening of businesses in an affected area should be addressed in future studies and should guide disaster recovery loan programs timing.

It was clear from interviewing loan counselors, reviewing articles on the failures of the traditional lending programs, and from the timeliness and effectiveness of making loans to affected companies by the READE 2 program that a consultative lending approach resulted in quicker and more certain funding. The intention of this program is to continue to provide business counseling while the loans are outstanding. It will be interesting and informative to know if the ongoing involvement of the loan counselors increases the likelihood of repayment over the eight year terms of the loans. Working with businesses from the point of creating projections for operations after restarting their business, through the implementation of the plan, is expected to result in materially improved performance for the affected businesses. Time will tell.

REFERENCES

Bielski, Lauren. (2002). Thinking the Unthinkable, *American Bankers Association. ABA Banking Journal*, Jan, 94(1),. 44 – 49.

Daugherty, S (2001). *Helping Small Businesses after Hurricane Floyd*, Popular Government Summer.

Grant, E. & Leibs, S. (2006). Flirting with Disaster Recovery. *CFO*, May, 22(6), 35 – 38.

Kinkade, Brenden. (2005). Is SMB Disaster Recovery Really Within Reach? *Computer Technology Review*, Feb , 25(2), 28 – 29.

Klein, K (2005). Rebuilding: A Deluge At The SBA. *BusinessWeek*, December 5.

La Fazia, Tim, Ames, Jeff & Koch, Reinhard.(2004). Avoid Disaster Through Planning, *Communication News*, Nov. 41(11), 20-25.

Office of State Budget and Management (2006). *North Carolina Disaster Recovery Guide.* Raleigh, North Carolina

Pofcher, Steven. (2005). The SMB Users Guide to Data Protection, *Computer Technology Review*, Feb , 25(2), 30 – 33.

Runyan, R.C. (2006). Small Business in the Face of Crisis: Identifying Barriers to Recovery from a Natural Disaster. *Journal of Contingencies and Crisis Management*. 14:(1), 12-26.

Scarinci, Cynthia. (2002). Contingency Planning for Small Business, *The CPA Journal*, Aug., 72(8), 65.

Seck, K. (2006). Kerry Introduces Bill to Improve Disaster Loan Program; Legislation Adds Government Accountability, Assistance for Disaster Victims. Retrieved September 10, 2006, from *U.S. Newswire* website: http://releases.usnewswire.com.

Tiller, Michael J. (2005). Is Your Disaster Plan Effective? *Management Review*, Apr., 83(4), . 57.

Yoshida, K. (2005). Determinants of Small Business Hazard Mitigation. *Natural Hazards Review* 6(1), 1-12.

THE NON-MOVER ADVANTAGE? SELF-EMPLOYMENT RATES IN NON-METROPOLITAN AREAS

Sherry Robinson, Penn State University

ABSTRACT

Non-metropolitan areas have traditionally been at a disadvantage in terms of economic development. The community characteristics that are conducive to the birth and survival of small businesses are often found lacking in rural areas. However, some studies have found the rate of self-employment to be higher in rural than in urban areas. While economic decline has led many workers to migrate to more developed areas, others have chosen to create their own jobs rather than to relocate and give up their way of life. This study seeks to provide further insight into this issue by examining the self-employment rates of movers and non-movers in urban, suburban and rural areas. The results show that although people in non-metropolitan areas generally have higher rates of self-employment than those in more urban locations, natives of non-metropolitan areas have even higher rates than those who moved to the rural area.

INTRODUCTION

Self-employment provides a work opportunity not only for those who seek independence and job flexibility, but also for those who cannot easily find suitable work due to their location or other limitations. Lichter (1989, p. 199, 200) points out that rural women in particular "have been an economically disadvantaged group historically" and face restricted employment opportunities. Both the quantity and quality of jobs in rural areas have been seriously affected by decreases in rural industries, including farming, and increased foreign competition (Lichter, 1989). This economic decline has led many workers to migrate to more developed areas, further decreasing the population and purchasing power in non-metropolitan areas.

Some rural residents may choose to create their own jobs rather than relocate. Previous research (e.g Clark & James, 1992; Robinson, 2003, 2002) has shown that non-metropolitan (non-metro) residents often have higher rates of selfemployments than their metropolitan (metro) counterparts. In their study of business owners in South Dakota, Tosterud and Habbershon (1992) found that many of those people had started businesses in order remain in their chosen location, which, in most cases, was very close to where they were born and raised. This study examines this issue further by comparing the 2005 self-employment rates of those who have and have not moved from their original locations, concluding that non-movers consistently have higher self-employment rates, especially in non-metro areas.

PROBLEMS AND OPPORTUNTIES FOR RURAL BUSINESS OWNERS

Numerous factors put rural areas at a disadvantage in terms of economic development and encouragement of entrepreneurship. Because of the lower levels of economic development, and perhaps because of the different lifestyle led by rural residents, "rural areas are seen by many as being on the fringe rather than a part of the mainstream of both the economy and society" (MacKensie, 1992, p. 92).

Naturally, rural areas have lower populations, but these residents also have less aggregate and individual buying power (Barkley, 1993; Kean, Gaskill, Letstritz, & Jasper, 1998). Metro and non-metro areas often have very different business environments due to such elements as geography, demographics and social networks (Beggs, Haines & Hurlbert, 1996; Frazier & Niehm, 2004). Lower levels of economic development, scarcity of affordable professional services, and smaller markets can present significant challenges to rural business owners (Chrisman, Gatewood, & Donlevy, 2002; Fendley & Christenson, 1989; Kale, 1989; Lin, Buss, & Popovich, 1990; Small Business Administration [SBA], 2001; Tigges & Green, 1994; Trucker and Lockhart, 1989).

Location may influence business starts and success in that geographic region is one determinant of the availability of needed resources (Chrisman et al., 1992). Rural areas often offer fewer support services and less-developed transportation and electronic infrastructures which could hinder non-metro businesses attempting internet-based businesses as well as brick and mortar operations as the cost and quality of telecommunications becomes increasingly important to businesses (Corman, Lussier, & Nolan, 1996; Freshwater, 1998; Robinson, 2004; SBA, 2001). Essential business services such as accounting, banking, advertising, and legal services may be both difficult to find and more expensive in rural areas (Corman et al., 1996; Fendley & Christenson, 1989; Frazier & Niehm, 2004; Freshwater, 1998; SBA, 2001; Trucker & Lockhart, 1989). In addition, the trend toward the merger of small banks with larger ones less willing to makes loans to small businesses combined with biases against non-urban areas, make it more difficult for small rural businesses to gain financing (Chrisman et al., 2002; Green & McNamara, 1987; SBA, 2001). These negative factors could logically lead to lower rates of self-employment in non-metro areas.

Despite these problems, some studies (Jack & Anderson, 2002; Robinson, 2001; Sullivan, Scannell, Wang, & Halbrendt, 2000; Tosterod & Habbershon, 1992) state that small business owners have found benefits to being located in a rural area. Taking population into consideration, Clark and James (1992) found the rate of business ownership to be higher in non-metro areas of the midwest. Lin and associates (1990) found no significant differences between rural and urban areas when comparing the rates at which new firms and jobs were created. Self-employment rates have been found to be higher in Pennsylvania's non-metro counties (Robinson, 2003). In addition, Hout and Rosen (2000) found that the sons of farmers, who are usually rural residents, had higher rates of self-employment than did sons of clerical, retail, and manual workers.

Even in areas where the environment would seem to work against entrepreneurs, business ownership provides an additional work alternative when job opportunities are unavailable or do not fulfill all of a person's needs (Tigges & Green, 1994). Many people in rural areas are limited by location, physical difficulty in commuting to a work site, or personal and family situations (Coates et al., 1991; Tigges & Green, 1994). Studying new business owners in South Dakota, Tosterud and Habbershon (1992) found that the majority of those people had started their businesses in order remain in their chosen location, which, in most cases, was less than 30 miles from where they had spent their entire lives. Given this, it seems logical that non-movers could have higher rates of self-employment, especially in rural areas.

This study further examines the self-employment rates of people who have not relocated from their original areas (non-movers), especially those who live in non-metro areas. In the following section, the methodology of this study is presented, along with the analysis of the results.

METHODOLOGY, RESULTS AND ANALYSIS

Data regarding the number of men and women who are self-employed, their location and migration status were gathered via Data Ferrett from the 2005 Current Population Survey's Annual Social and Economic (March) Supplement. People who moved were categorized by the location and direction of their move--MSA to MSA, non-MSA to MSA, MSA to non-MSA, etc. For the purposes of this study, everyone who had moved was grouped into one category for comparison with non-movers. The population for this study was taken from the variable "class of worker," which includes people employed by the government and private enterprises, as well as the self-employed (incorporated and unincorporated), unpaid workers and those who have never worked. People under age 18 were not included. The geographic categories in this study are based on the Census Bureau's classifications of principal city, balance metro and non-metro. Although technical definitions vary, in this study the terms "rural" and "non-metro" are used synonymously.

Chi-square analyses were performed on these data to determine if there were significant associations between the number of movers and non-movers who were self-employed and the geographical variable principal city/balance metro/non-metro. Totals were compared, as were the sexes, such that men were compared to men, and women to women. In every case, the resulting chi-square statistics were very high and $p<.000$.

As shown in Tables 1, 2 and 3, non-metro residents had higher percentages of unincorporated self-employed workers. However, these proportions, which were determined by dividing the number of self-employed by the total number of people in that category (for example, non-movers in non-metro areas), were even higher among non-movers. In fact, non-metro non-movers were almost 70% more likely than non-metro movers to be self-employed (non-incorporated). Among men, non-metro non-movers were 53% more likely to be self-employed (non-incorporated), but among women, non-metro non-movers were twice as likely to be self-employed (non-incorporated). In fact, non-metro women's 7.93% is second only to both categories of non-metro men, topping all other women and men.

Among the incorporated self-employed, a slightly different story emerged. Those in the balance metro category had the highest rates, but once again, non-movers had higher proportions than movers. In this case, the numbers and corresponding percentages were smaller, but the non-movers of the balance metro category were 51% (total), 63% (men) and 32% (women) more likely to be (incorporated) self-employed than their counterparts who were movers. Therefore, in all direct comparisons, non-movers had significantly higher rates of self-employment.

Table 1. Self-employment Rates Among Movers and Non-movers By Geography				
Total	Total	Principal City	Balance Metro	Non-metro
Movers	18,436,215	6,884,967	8,457,011	3,094,236
-Self-emp'd (incorporated)	407,240	104,930	257,057	45,254
	2.21%	1.52%	3.04%	1.46%
-Self-emp'd (unincorporated)	973,799	336,076	441,157	196,566
	5.28%	4.88%	5.22%	6.35%
Non-movers	106,799,162	30,090,706	56,159,254	20,549,202
-Self-emp'd (incorporated)	4,205,474	923,294	2,588,264	693,916
	3.94%	3.07%	4.61%	3.38%
-Self-emp'd (unincorporated)	8,104,046	2,041,096	3,863,518	2,199,431
	7.59%	6.78%	6.88%	10.70%

Table 2. Self-employment Rates Among Men Movers and Non-movers By Geography				
	Total	Principal City	Balance Metro	Non-metro
Men movers	10,137,447	3,788,213	4,750,830	1,598,403
-Self-emp'd (incorporated)	289,553	74,321	183,642	31,590
	2.86%	1.96%	3.87%	1.98%
-Self-emp'd (unincorporated)	973,799	336,076	441,157	196,566
	6.55%	6.11%	6.20%	8.62%
Men Non-movers	56,947,896	15,970,804	30,101,047	10,876,045
-Self-emp'd (incorporated)	3,081,170	678,717	1,904,346	498,106
	5.41%	4.25%	6.33%	4.58%
-Self-emp'd (unincorporated)	5,038,245	1,255,769	2,350,394	1,432,081
	8.85%	7.86%	7.81%	13.17%

Table 3. Self-employment Rates Among Women Movers and Non-movers By Geography				
	Total	Principal City	Balance Metro	Non-metro
Women Movers	8,298,768	3,096,754	3,706,181	1,495,833
-Self-emp'd (incorporated)	117,687	30,609	73,415	13,663
	1.42%	0.99%	1.98%	0.91%
-Self-emp'd (unincorporated)	309,608	104,454	146,431	58,722
	3.73%	3.37%	3.95%	3.93%
Women Non-movers	49,851,266	14,119,902	26,058,208	96,73,157
-Self-emp'd (incorporated)	1,124,305	244,577	683,918	195,810
	2.26%	1.73%	2.62%	2.02%
-Self-emp'd (unincorporated)	3,065,801	785,327	1,513,124	767,350
	6.15%	5.56%	5.81%	7.93%

Because many people with private sector jobs also have their own businesses as second jobs, the "private" component of the "class of worker" variable was isolated. From this group, the subset of people with second jobs (other work) was selected in order to determine the proportions of these private workers who declared self-employment as their other work (SEOTR). Tables 4, 5 and 6 show the numbers and proportions of all movers and non-movers who primarily work for a private employer, but also have another type of work and the proportions of these people whose other job is self-employment. These self-employment rates were determined by dividing SEOTR by the total number of people in that category with other jobs. Chi-square analyses with geography and migration status again resulted in very high chi-square statistics and $p<.000$ for all comparisons.

Again, with the total workers, men and women, non-movers had higher rates of self-employment, this time in regard to other work. Among non-movers, non-metro areas showed the highest rates, consistent with pattern of primary job (unincorporated) self-employment rates. However, this trend was reversed among movers, with the highest rates shown in principal cities and the lowest in non-metro areas.

Table 4. SEOTR Rates Among Movers and Non-movers By Geography				
	Total	Principal City	Balance Metro	Non-metro
Total movers	18,436,215	6,884,967	8457011	3094236
Movers with other jobs	2,644,824	905,567	1195484	543774
	14.35%	13.15%	14.1,4%	17.,57%
-SEOTR	327,599	125,641	147,002	54,955
	12.39%	13.87%	12.30%	10.,11%
Total non- overs	106,799,162	30,090,706	56,159,254	20,549,202
Non-movers /other jobs	8,294,315	2,135,697	4,359,562	1,799,056
	7.77%	7.10%	7.76%	8.75%
-SEOTR	1,458,967	368,851	744,608	345,507
	17.59%	17.27%	17.08%	19.20%

Table 5. SEOTR Rates Among Men Movers and Non-movers By Geography				
	Total	Principal City	Balance Metro	Non-metro
Total men movers	10,137,447	3,788,213	4,750,830	1,598,403
Men movers with other jobs	1,413,713	471,071	661,275	281,266
	13.95%	12.44%	13.92%	17.60%
-SEOTR	188,546	72,510	86,981	29,055
	13.34%	15.39%	13.15%	10.33%
Total men non-movers	56,947,896	15,970,804	30,101,047	10,876,045
Men non-movers/other jobs	4,427,177	1,103,590	2,303,000	1,020,587
	7.77%	6.91%	7.65%	9.38%
-SEOTR	871,757	201,996	455,836	213,925
	19.69%	18.30%	19.79%	20.96%

Table 6. SEOTR Rates Among Women Movers and Non-movers By Geography				
	Total	Principal City	Balance Metro	Non-metro
Total women movers	8,298,768	3,096,754	3,706,181	1,495,833
Women movers/other jobs	1,231,112	434,496	534,209	262,407
	14.83%	14.03%	14.41%	17.54%
-SEOTR	139,052	53,131	60,021	25,900
	11.29%	12.23%	11.24%	9.87%
Total women non-movers	49,851,266	14,119,902	26,058,208	9,673,157
Women non-movers/other	3,867,138	1,032,107	2,056,562	778,469
	7.76%	7.31%	7.89%	8.05%
-SEOTR	587,210	166,855	288,773	131,582
	15.18%	16.17%	14.04%	16.90%

It is also interesting to note that although non-movers had significantly higher proportions of people whose other work involved self-employment, movers were about twice as likely to have secondary work of any type. For example, 14.35% of all movers engaged in other work, while only 7.77% of non-movers had second jobs. However, of these people with other work, 17.59% of non-movers' other work was self-employment, but that proportion dropped to 12.39% for movers.

Taken together, the results of this study show that non-movers were more likely to be self-employed regardless of location, sex or incorporation status. Among those who work primarily for a private employer but have a second job, non-movers again had higher rates. Non-metro residents regardless of migration status had the highest rates for unincorporated self-employment with the exception of non-metro women movers whose 3.93% was second to balance metro's 3.95%. The same pattern was found with SEOTR non-movers. Interestingly, this trend was reversed among SEOTR movers as non-metro residents consistently had the lowest self-employment-as-other-work rates, despite the fact that non-metro residents were also the most likely to have second jobs.

CONCLUSION

Entrepreneurship provides rural residents an avenue for financial improvement and independence without giving up their unique way of life (Tosterud & Habbershon, 1992).) Established social networks can make it easier for residents in tightly-knit rural communities to start and maintain businesses (Cooke & Morgan, 1998; Frazier & Niehm, 2004; Jenssen & Keonig, 2002; McQuaid, 1997; Robinson, 2001; Sullivan et al., 2000). These social bonds are likely to be influenced by migration status and the number of other people who were born and raised there (i.e. non-movers). This would be consistent with qualitative data from Robinson and Watson (2001) in which a respondent is quoted as saying, "If I lived in a more populated area…I might not have done it as quickly." However, even in principal cities, non-movers had higher rates of self-employment, which could suggest that people who are natives to a given location are more willing to open businesses there.

Considering past research relating rural small business owners' desire to live in their home locations, and the high rates of self-employment among non-movers in non-metro areas, this study supports the notion that rural residents in particular may prefer to create their own jobs than to move away. This may be especially true among women, who are likely to have fewer job opportunities that meet their needs. Future research should be conducted to analyze this relationship in greater detail. If the people most willing to create their own employment are non-movers, it is important for local authorities and agencies to provide necessary education and training within the area, and to assist local residents in their efforts to create businesses, and possibly jobs.

According to Henderson (2002), rural companies tend to be smaller and have less income than those in metro areas. Although size was not a variable in this study, it seems likely that incorporated businesses would be larger than unincorporated ones. Glancey (1998) adds that small business owners in urban areas may be more interested in growth whereas rural business owners may be primarily motivated by lifestyle, which could lead to more small, unincorporated businesses in rural areas, and would be consistent with the findings of this study. The higher rates of incorporated self-employment in balance metro areas may be associated with larger businesses in more populated or wealthier areas. Future research should explore the relative size of businesses not only by location, but according to mover/non-mover status.

REFERENCES

Barkley, D. L. (1993). *Economic adaptation: Alternatives for non-metropolitan areas.* Boulder, CO: Westview Press.

Beggs, J. H., Haines, V., & Hurlbert, J. (1996). Revisiting the rural-urban contrast: Personal networks in nonmetropolitan and metropolitan settings. *Rural Sociology*, 61(2), 306-325.

Chrisman, J. J., Gatewood, E., & Donlevy, L. B. (2002). A note on the efficiency and effectiveness of outsider assistance programs in rural versus non-rural states. *Entrepreneurship Theory and Practice,* 26(3), 67-80.

Clark, T., & James, F.J. (1992). Women-owned businesses: Dimensions and policy issues. *Economic Development Quarterly,* 6(1), 25-40.

Cooke, P., & Morgan, K. (1998). *The association economy.* Oxford: Oxford University Press.

Corman, J., Lussier, R. N., & Nolan, K. G. (1996). Factors that encourage entrepreneurial start-ups and existing firm expansion: A longitudinal study comparing recession and expansion periods. *Academy of Entrepreneurship Journal,* 1(2).

Fendley, K., & Christenson, J. A. (1989). Rural reflation: An idea for community development. *Journal of the Community Development Society*, 20(1), 103-115.

Frazier, B. J., & Niehm, L. S. (2004). Exploring business information networks of small retailers in rural communities. *Journal of Developmental Entrepreneurship*, 9(1), 23-42.

Freshwater, D. (1998). Rural America's information age: The economic future of rural communities depends on their ability to take advantage of emerging telecommunications technologies. *Forum for Applied Research and Public Policy,* 13(4), 72-78.

Glancey, K. (1998). Determinants of growth and profitability in small entrepreneurial firms. *International Journal of Entrepreneurial Behavior & Research,* 4(1).

Green, G. P., & McNamara, K. T. (1987). Traditional and nontraditional opportunities and alternatives for local economic development. In L. J. Beaulieu (Ed.), *The rural south in crisis*: *Challenges of the future*. Boulder, CO: Westview Press.

Henderson, J. (2002). Building the rural economy with high-growth entrepreneurs. *Economic Review*, 3rd Quarter, 45-70.

Hout, M. & Rosen, H. (2000). Self-employment, family background, and race. *Journal of Human Resources*, 35(4), 670-692.

Jack, S. L., & Anderson, A. R. (2002). The effects of embeddedness on the entrepreneurial process. *Journal of Business Venturing*, 17, 467-487.

Jenssen, J. I., & Koenig, H. F. (2002). The effect of social networks on resource access and business start-ups. *European Planning Studies*, 10(8), 1039-1046.

Kale, S. (1989). Theoretical contributions to the understanding of U.S. Non-metropolitan Economic Change. *Economic Development Quarterly,* 3, 58-69.

Kean, R., Gaskill, L., Leistritz, L., & Jasper, C. (1998). Effects of community characteristics, business environment, and competitive strategies on rural retail business performance. *Journal of Small Business Management,* 36(2), 45-57.

Lichter, D.T. (1989). The underemployment of American rural women: Prevalence, trends and spatial inequality. *Journal of Rural Studies,* 5(2), 199-208.

Lin, X, Buss, T.F., & Popovich, M. (1990). Entrepreneurship is alive and well in rural America: A four-state study. *Economic Development Quarterly,* 4 (3), 254-259.

MacKenzie, L. R. (1992). Fostering entrepreneurship as a rural economic development strategy. *Economic Development Review*, Fall, 38-44.

McQuaid, R. W. (1997). Local enterprise companies and rural development. *Journal of Rural Studies,* 13(2), 197-212.

Robinson, S. (2003). Self-employment in metropolitan and non-metropolitan Pennsylvania Counties. *Proceedings of the Academy of Entrepreneurship*, Fall, 21-25.

Robinson, S. (2002). Business start and termination rates: An examination of rural and non-rural areas. *Academy of Entrepreneurship Journal*, 8(1) 79-86.

Robinson, S., (2001). An examination of entrepreneurial motives and their influence on the way rural women small business owners manage their employees. *Journal of Developmental Entrepreneurship,* 6(2), 151-167 .

Robinson, S. & Shah, S. (2004). Delving into the digital divide: Computer use among the self-employed in metropolitan and non-metropolitan areas. *Academy of Entrepreneurship Journal,* 10(2), 115-136.

Robinson, S. & Watson, J. (2001). Female entrepreneur underperformance: A puzzle for the information age. *Journal of International Information Management*, 10(1), 45-56.

Small Business Administration. (2001). *Advancing rural America*. Washington, D.C.: Office of Advocacy.

Sullivan, P., Scannell, E., Wang, Q., & Halbrendt, C. (2000). Small entrepreneurial business: A potential solution to female poverty in rural America. Retrieved October 23, 2000, from Http:www.sbaer.uca/edu/Docs/ProceedingsII/97ICS257.TXT

Tigges, L. M., & Green, G. P. (1994). Small business success among men- and women-owned firms in rural areas. *Rural Sociology,* 59, 289-309.

Trucker, S. W., & Lockhart, C. D. (1989). Maryland small business development financing authority's equity participation investment program. *Economic Development review*, 7(2), 60-61.

Tosterud, R. J., & Habbershon, G. (1992). Rural entrepreneurship: A preliminary study. *South Dakota Business Review,* March.

EMINENT DOMAIN: WHAT HAPPENS WHEN THE STATE TAKES PART OF YOUR LAND?

James W. Carland, Western Carolina University
JoAnn C. Carland, Western Carolina University

ABSTRACT

In North Carolina, as in most states, the Department of Transportation takes land from hundreds of businesses each year for the purpose of widening roads, building new roads, or improving road systems. Using the power of eminent domain to expropriate the land, the state typically employs two independent real estate appraisers to establish a fair market value for the land and averages those to arrice at a compensation price which is paid to the land owner. When the land is owned by a business and is a critical part of the operations of that business, such a technique for arriving at a value is unfair. Nevertheless, the state does not recognize business valuation techniques, so what is an entrepreneur to do?

This paper presents a case study of a business faced with this scenario which decided to take legal action. The business was a cemetary which was devastated by the taking. The owner retained an attorney and sued the state for damages sustained in the taking. The authors were retained to establish a value for the damages sustained and to argue for a different approach to valuation in eminent domain actions of this kind.

THE SITUATION

On March 14, 2004, the state of North Carolina took part of the cemetery belonging to Jackson County Cemetery, Inc. to widen the road in that area of the county. The Department of Transportation employed two licensed real estate appraisers to value the land. Both examined recent sales of vacant land in the county and used the data as comprables to determine a value of the acreage. Based upon their appraisals, the DOT established a price of $25,000 for the land.

The strip of land that the State took required 5 graves to be moved, and the DOT paid for that to be accomplished. However, the owner of the cemetery claimed that the action rendered 316 graves sites unsalable. This resulted from the loss of the land and the inability to use the expanded right of way for burial sites. The impact of this loss was dramatic, and the owner protested the $25,000 price. The DOT was firm, and mailed him a check, and moved forward to expand the road.

The owner retained an attorney to sue the State. The attorney retained the authors to act as expert witnesses in the litigation and to establish a value for the venture. The issue, as explained by the attorney, was that the State would not recognize a business value. The only grounds for the litigation would be to try to show that the eminent domain action damaged the value of the business. We suggested treating the action as a taking of inventory, and establishing a value for that inventory, but the legal strategy which the attorney decided to pursue required us to demonstrate that the value of the business itself had been impaired.

Although we had valued a number of businesses, we had never appraised a cemetery. This made the case especially interesting, as did the prospects for persuading the State to accept a different premise for valuing land in eminent domain actions involving businesses. Armed with accounting records and copies of the State's appraisals, we had to find a way to attack the issue.

DEFINITION AND PREMISE OF VALUE

Generally, an appraisal of a business is oriented toward expressing an opinion of the *fair market value*, as defined in Appendix A (Miles, 1984; NACVA Standards, 1996). This value is typically determined by applying the *elements of appraisal,* as defined in Appendix A (Revenue Ruling 59-60, 1959; Pratt, Reilly & Schweihs, 1996; NACVA, 1998). In this case we want to establish a value before and after the eminent domain action and we decided to employ an income approach.

The business in question is a perpetual care cemetery which receives income from the sale of grave sites, burial vaults and monuments. The cemetery also receives income from the investment of deposits made with the North Carolina Cemetery Commission for the purpose of perpetual care. Such a business operates in a highly different fashion because its inventory is fixed. In other words, when all of the grave sites have been sold, the cemetery operation will cease to exist. It will then be converted into a perpetual care firm which has as its only source of revenue the investment income from trust deposits. Consequently, the result of the taking of property in this case impacts the company by eliminating a portion of its inventory, inventory which cannot be replaced, and therefore reduces its future cash flows.

The literature of the business appraisal profession makes it clear that the best approach to valuation in this circumstance is the *Discounted Future Earnings Approach,* which is defined in Appendix A as an income-oriented method of estimating economic value (Miles, 1984). This approach is sometimes called the *Investment Value Approach,* which is defined in Appendix A, as an income-oriented method of estimating economic value. Application of this approach requires one to forecast the cash flows which would have been created by the operation of the cemetery had the eminent domain action not occurred. Following that forecast, one must capitalize those cash flows at an appropriate rate (Carland & White, 1980; Miles, 1984; Pratt, Reilly & Schweihs, 1996; NACVA, 1998; Black & Isom Associates, 1995).

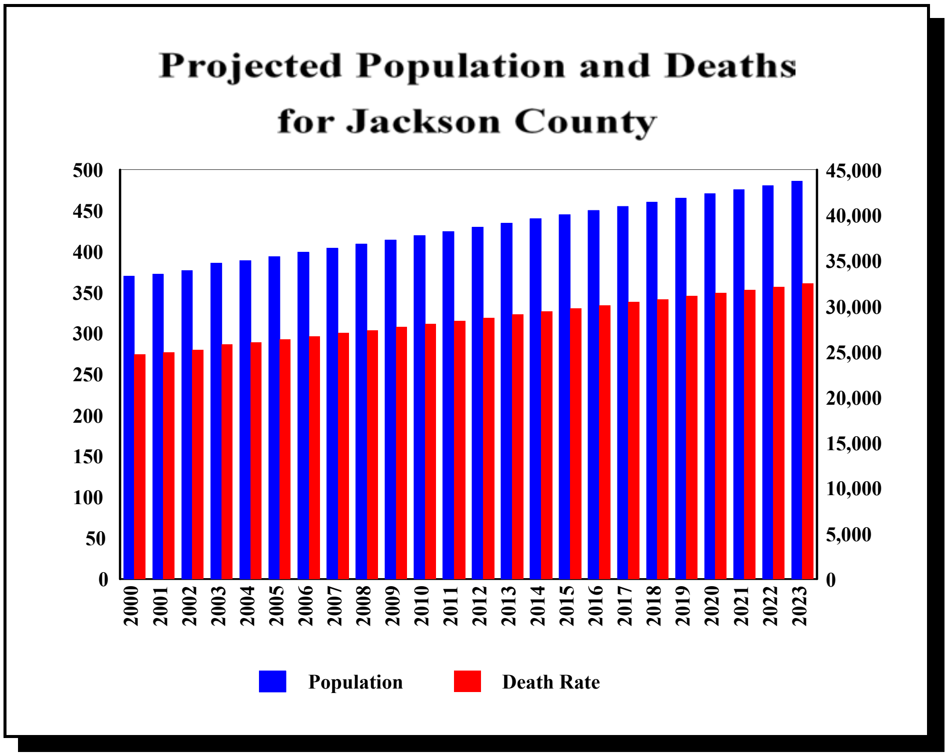
Based upon the standards of the scientific community of appraisers, we determined that the best approach to valuation in this case was to prepare a forecast of lost net cash flows which were created by the taking of irreplaceable inventory, and to capitalize those cash flows. This will require a *closed end forecast*, rather than the *perpetuity* which is so often used in business appraisals, simply because the losses will cease when the inventory is depleted. We then used this calculation in our completion of before and after values for the firm.

POPULATION TRENDS AND DEATH RATES

Having determined the appropriate method to value the lost cash flows, we are faced with the need to forecast the rate at which the inventory would have been sold. Because the sales of grave sites and related products are a function of market demand, we determined that the best approach to this forecast would be to utilize the population trends in Jackson County, and to approximate the death rate which will occur in the County.

We examined the population for Jackson County as reported by the Bureau of the Census on its website (http://quickfacts.census.gov/qfd/states/37000lk.html) for 2000, 2001, 2002, and 2003. We then extrapolated this trend by the least squares method through the year 2024. The results are displayed in the graph below, with the population trend tied to the right hand y axis.

Secondly, we investigated the death rate for the United States. That information is presented by the Central Intelligence Agency in the CIA World Fact Book. The estimate for the death rate in 2005 is 8.25 deaths per one thousand people (http://www.cia.gov/cia/publications/ factbook/geos/us.html). We applied that death rate to the population projection for Jackson County and forecasted the death rate through the year 2024. The results are displayed in the graph below with the death forecast tied to the left hand y axis.



We consider this to be a conservative estimate because our readings and investigations indicate that expectations are for a rising death rate in the U.S., due to the aging of the population. Considering such an increase in the death rate would result in a more rapid growth in the market demand.

PROJECTED SALES OF GRAVE SITES

With the forecast for market demand in hand, we compared the actual sales of grave sites in the Jackson County cemetery, as reported in the company's financial reports, for 2001, 2002, and 2003, to the estimated death rate in the County for those same years and obtained an average market share for the three year period of 14.3%. We utilized this estimate of market share to forecast the sales of grave sites from 2005 to the point at which the inventory would have been exhausted, which we predict to occur in 2023. Specifically, we multiplied the projected deaths in Jackson County for each year by 14.3%, the historic market share taken from the subject firm's records. The results of those calculations are displayed in Table 1, rows one and two.

Next, we applied the ratio of sites rendered unsalable by the taking, 316, to the total available sites, 875, to arrive at an estimate of the number of affected sites which would have been sold in each year, 36%. Specifically, we multiplied the projected sales for each year by 36% to arrive at the forecast of lost sales from affected sites. The results of those calculations are displayed in Table 1, rows three and four.

Table 1: Projected Sales of Affected Grave Sites

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Projected Sales	42	42	43	43	44	45	45	46	46	47	47	48	48	49	49	50	51	51	38
Cumulative Sales	42	84	127	171	215	259	304	350	396	443	490	538	587	635	685	735	785	837	875
Lost Sales	15	15	16	16	16	16	16	16	17	17	17	17	17	18	18	18	18	18	14
Cumulative Lost Sales	15	30	46	62	78	94	110	126	143	160	177	194	212	229	247	265	284	302	316

We consider this to be a conservative estimate of the potential sales which could have occurred, as we based it upon extrapolations of actual population statistics for Jackson County, a flat death rate derived from national averages, and actual grave site sales for the three years preceding the taking.

PROJECTED LOST CASH FLOWS

Armed with the forecast of lost sales in units, we converted the estimate into projected cash flows by applying information provided by the client. That information indicated that grave sites sold for an average of $1,000, plus a $100 perpetual care fee which was deposited in the North Carolina Cemetery Commission Perpetual Care Trust. To establish that the selling price was competitive in the market, we examined the prices for grave sites in several comparable cemeteries in adjacent counties. At or near the end of 2003, Garrett Cemetery in Waynesville was charging $840 to $990 per grave site; Pisgah Park in Candler was charging $750 to

$950; and Forest Park in Candler was charging $950 to $1,415. Consequently, we accepted the stated selling price as a fair value for the grave sites in the subject firm.

The information provided by the subject firm indicated that opening and closing fees for grave sites were $800. We assessed no costs against these charges as all opening and closing work is done by in-house personnel, using company equipment. Consequently, the costs of opening and closing are a normal part of the overhead of the firm. We did investigate whether the prices were reasonable in the market place. At or near the end of 2003, Garrett Cemetery in Waynesville was charging $850 to $950 per opening/closing; Pisgah Park in Candler was charging $495 to $795; and Forest Park in Candler was charging $695 to $1,000. Consequently, we accepted the stated fees as a fair value for opening and closing services in the subject firm.

The information provided by the subject firm indicated that the average price of a vault was $2,000, with a cost for the vault of 50%, or $1,000, for a net cash flow of $1,000. In examining the average charges for vaults, we learned that selling prices at other cemeteries near the end of 2003 ranged from $969 to $2,425. Consequently, we accepted the stated price as a fair value for a vault in the subject firm. Further, the information provided by the subject firm indicated that in 2003 a policy had been implemented which required all purchasers of grave sites to acquire burial vaults from the firm. Our research indicated that such a requirement had become commonplace in the industry in the last few years. Consequently, we accepted the sales ratio of 100% of vault sales to grave site sales to be representative of the future revenues of the firm.

The information provided by the subject firm indicated that monuments ranged in price from $700 to $3,500, or an average of $2,125, with a 50% cost ratio. This produces an average cash flow for each sale of $1,062. The information from the subject firm indicated that it expected to sell monuments to at least 90% of the purchasers of grave sites. Recognizing that the subject firm had implemented a policy in January, 2003, in a second cemetery, Swain Park, which required all monuments to be purchased in-house, and noting that the same policy is generally enforced in the cemetery under investigation, we took the ratio of monument sales to grave sites to be representative of the cash flows which would occur in the future.

Finally, the subject firm indicated that it had earned 7.1% in 2004, and 2.8% in 2005, on its perpetual care trust deposits. Consequently, we took 5% per year to be a representative average earnings on the trust deposits for the future years until the cemetery lots are exhausted.

Now, we multiplied the lost sales of sites by the net cash flow which would have resulted from the sale of a grave site; by the net cash flow which would have occurred from the sale of a vault; by the net cash flow which would have occurred from opening and closing fees; and by 90% of the net cash flow which would have occurred from the sale of an average monument. Finally, we multiplied the cash flow from the accumulating trust deposits, $5 per year (5% of $100), by the forecast of site sales. This cash flow rises each year as it includes the income from all of the previous trust deposits, as well as the deposits for the year of sale. We summed the cash flows from each source of revenue to arrive at the total lost cash flows, and summed those over the entire period to arrive at the total lost cash flow to the subject firm. The results of our calculations are displayed in Table 2.

Table 2: Projected Lost Cash Flows

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
# Sites	15	15	16	16	16	16	16	16	17	17	17	17	17	18	18	18	18	18	14
Graves	15,000	15,000	16,000	16,000	16,000	16,000	16,000	16,000	17,000	17,000	17,000	17,000	17,000	18,000	18,000	18,000	18,000	18,000	14,000
Vaults	15,000	15,000	16,000	16,000	16,000	16,000	16,000	16,000	17,000	17,000	17,000	17,000	17,000	18,000	18,000	18,000	18,000	18,000	14,000
Monuments	14,344	14,344	15,300	15,300	15,300	15,300	15,300	15,300	16,256	16,256	16,256	16,256	16,256	17,213	17,213	17,213	17,213	17,213	13,388
Openings	12,000	12,000	12,800	12,800	12,800	12,800	12,800	12,800	13,600	13,600	13,600	13,600	13,600	14,400	14,400	14,400	14,400	14,400	11,200
Trust	75	150	230	310	390	470	550	630	715	800	885	970	1,055	1,145	1,235	1,325	1,415	1,505	1,575
Total	56,419	56,494	60,330	60,410	60,490	60,570	60,650	60,730	64,571	64,656	64,741	64,826	64,911	68,758	68,848	68,938	69,028	69,118	54,163
Total Lost Cash Flow																			**$1,198,649**

We consider these estimates to be conservative because they hold all prices constant throughout the period of the forecast. In reality, we can expect the rising scarcity of grave sites which will evolve as the cemetery fills to drive prices up faster than the inflation rate. In fact, investigation of selling prices for grave sites in the region suggests that they have been subject to significant increases in the last few years.

DEVELOPMENT OF THE CAPITALIZATION RATE

In general the scientific community of business appraisers view the appropriate development of a *capitalization rate,* as defined in Appendix A, to be a combination of a risk free interest rate and selected premiums for various types of risk to which any investor in the cash flows would be exposed (Carland & White, 1980; Miles, 1984; NACVA Standards, 1996; Pratt, Reilly & Schweihs, 1996;

NACVA, 1998). This is frequently referred to as the *build up method* (Pratt, Reilly & Schweihs, 1993).

A strong approach is to use the yield on U.S. Treasury Bonds as a proxy for the risk free rate, then to add risk premiums for competition, financial strength, management, earnings stability, market conditions, and potential economic changes (Black & Isom Associates, 1995). As the period involved is a forecast encompassing 19 years, we selected the yield on the U.S. 20 Year Treasury Bond which was in effect on March 14, 2004, the date of the taking. That rate was 4.67% (www.ustreas.gov/offices/domestic-finance/debt-management/interest-rate/yield_historical_2004.shtml). We added premiums for the risks enumerated above. The results are displayed in Table 3.

Table 3
Build Up of Capitalization Rate

US 20 Year Bond Rate at 3/14/04	4.67%
Risk Factor for Competition	1.00%
Risk Factor for Financial Strength	1.00%
Risk Factor for Management	1.00%
Risk Factor for Earnings Stability	1.00%
Risk Factor for Market Changes	5.00%
Risk Factor for Economic Changes	1.00%
Total Discount Rate	14.67%

As Table 3 indicates, we assessed a small risk factor for competition, 1%, because there is very little competition for perpetual care cemeteries in the market area. We assessed a low risk factor for financial strength, 1%, because the company was financially strong prior to the taking. We assessed a low risk factor for management, 1%, because we believe the firm to be well managed. Investigation of the cemetery indicates that it is well maintained and attractive. We assessed a low risk factor for earnings stability, 1%, because the cemetery industry at large is highly stable (Ninker, 2002; Shipper & Boli, 1999) and very stable in Jackson County. Skipping to economic change risk, we do not believe that economic factors will greatly affect the subject cemetery. Jackson County is stable economically, and the cemetery industry is largely unaffected by economic changes because the death rate mandates consumption, regardless of conditions. Consequently, we applied a small risk factor, 1%, for this item, as well. We applied a relatively large risk factor, 5%, for market changes. The market can be expected to be impacted by the rising popularity of cremation (Ward, 2004; Ninker, 2002). The results of our calculations, as displayed in Table 3, suggest that 14.67% is an appropriate capitalization rate for the cash flows.

DETERMINATION OF THE NET PRESENT VALUE OF THE CASH FLOWS

The final step in the valuation process is to calculate the value of the projected lost net cash flows at the date of taking, March 14, 2004, by applying the capitalization rate from Table 3. This requires recognition of the time value of money. If one had the choice between receiving $1,000 today, or $1,000 one year from today, one would clearly choose today. That is because money in hand today could be invested to earn more money over the course of the next year.

Our capitalization rate says that given the risk in this enterprise, a prudent investor would require a return of 14.67% per year. Consequently, $100 would earn $14.67, for a total of $114.67, over the course of the next year, and $16.82 ($114.67 times 14.67%), for a total of $131.49, over the course of year two, and so forth. The mathematics of the process are that the principal can be multiplied by 114.67% for each year involved in the forecast of cash flows. That would be (114.67%) in year one, $(114.67\%)^2$ in year two, $(114.67\%)^3$ in year three, $(114.67\%)^4$ in year four, and so forth. That operation produces the same result as calculating the interest each year and adding to the principal: $\$100 \text{ X } (114.67\%)^2 = \$131.49$; $\$100 \text{ X } (114.67\%)^3 = \$150.78$; and, so forth.

Our requirement is to move the cash flows backwards in time to the date of the taking. Specifically, we want to know the value of the cash flows that we predict to occur in 2005, 2006, 2007, and each year of the forecast, on March 14, 2004. To move cash flows backward in time, we reverse the process of interest accumulation. That means that to move the future cash flows backwards in time, we *divide* by the interest factor. This tells us how much money we would have required on March 14, 2004, in order for that amount to have produced the same cash flows that we have forecast over the period. That means that we move the cash flows for 2005 back to March 14, 2004 by dividing the 2005 cash flows by (114.67%). We move the cash flows for 2006 back to March 14, 2004, by dividing the 2006 cash flows by $(114.67\%)^2$. We move the cash flows for 2007 back to March 14, 2004, by dividing the 2007 cash flows by (114.67%)^3, and so forth. The results of our calculations are displayed in Table 4.

As Table 4 shows, the value of the $1,198,649 in lost cash flows is worth $384,847 at the date of taking, March 14, 2004. The dramatic decline in value is the result of the impact of the time value of money and the length of time required to exhaust the inventory of grave sites, 19 years.

Table 4: Net Present Value Calculations for Projected Lost Net Cash Flows

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Flows	56,419	56,494	60,330	60,410	60,490	60,570	60,650	60,730	64,571	64,656	64,741	64,826	64,911	68,758	68,848	68,938	69,028	69,118	54,163

	Current Value	Value at 3/14/2004		
Present Value of 2005 Net Cash Flows	56,419	49,201		
Present Value of 2005 Net Cash Flows	56,494	42,964		
Present Value of 2007 Net Cash Flows	60,330	40,011		
Present Value of 2008 Net Cash Flows	60,410	34,939		
Present Value of 2009 Net Cash Flows	60,490	30,509		
Present Value of 2010 Net Cash Flows	60,570	26,642		
Present Value of 2011 Net Cash Flows	60,650	23,264		
Present Value of 2012 Net Cash Flows	60,730	20,314		
Present Value of 2013 Net Cash Flows	64,571	18,836		
Present Value of 2014 Net Cash Flows	64,656	16,448		
Present Value of 2015 Net Cash Flows	64,741	14,363		
Present Value of 2016 Net Cash Flows	64,826	12,542		
Present Value of 2017 Net Cash Flows	64,911	10,951		
Present Value of 2018 Net Cash Flows	68,758	10,116		
Present Value of 2019 Net Cash Flows	68,848	8,834		
Present Value of 2020 Net Cash Flows	68,938	7,714		
Present Value of 2021 Net Cash Flows	69,028	6,736		
Present Value of 2022 Net Cash Flows	69,118	5,882		
Present Value of 2023 Net Cash Flows	54,163	4,609		
Totals	**1,198,649**	**384,874**	**Net Present Value per Grave Site**	**1,218**

FAIR MARKET VALUE OF THE COMPANY BEFORE THE TAKING

To determine the impact of the taking on the value of the firm, we began by establishing a fair market value for Jackson County Cemetery, Inc. at the date of the eminent domain action. The company is an S Corporation with related divisions with which it shares management, overhead, and operational support. Consequently, Jackson County Cemetery cannot be valued as a stand alone unit, and the value of the entire firm must be established in order to determine the impairment created by the taking of the cemetery sites.

The Company provided tax returns for the years 2001, 2002, 2003, and 2004. We examined these tax returns and the trial balances which were prepared by the company to support the generation of the tax returns. That examination made it clear that the divisions of the company cannot be separated into stand alone units.

Table 5 displays the sales, cost of sales, gross profit, depreciation, profit and cash flows for those years taken from the tax returns. We employed this data to arrive at an opinion of the fair market value of the Company absent the taking. As the table shows, the company did experience a significant decline in sales during 2004. Given the growth in revenues which had occurred between 2001 and 2003, this decline is clear evidence that the taking has impacted the value of the firm.

Table 5: Historic Data for Jackson County Cemetery, Inc.

	2001	2002	2003	2004	Avg 02-04
Sales	789,056	1,126,087	1,354,515	1,028,459	1,169,687
Cost of Sales	216,272	250,861	400,206	265,379	305,482
Gross Profit	572,784	875,226	954,309	763,080	864,205
Gross Profit Ratio	72.59%	77.72%	70.45%	74.20%	74.12%
Depreciation	88,085	145,919	119,628	108,071	124,539
Profit	-191,161	-24,022	45,308	-25,713	-1,476
Net Cash Flow	-103,076	121,897	164,936	82,358	123,064
Net Cash Flow Ratio to Sales	-13.06%	10.82%	12.18%	8.01%	10.34%
Average Overhead Cost	675,860	753,329	789,373	680,722	741,141

Cash flows for the firm are calculated by adding the depreciation to the profit, because depreciation is a non cash expense. However, the results for 2001 were not indicative of the value of the firm because that year displayed a large negative cash flow. Consequently, we determined that the conservative approach to valuation would be to utilize 2004 as part of the trend data despite the fact that those results were impaired by the taking. Table 5 displays averages for the years 2002 through 2004.

As established in the appraisal literature, valuing a business involves estimating the cash flows which the business generates, and which the business can be expected to generate in the future. We employed the average net cash flows for 2002 through 2004, $123,000, shown in Table 5 as an estimate for the cash flows which the business could have been expected to produce in the future had it not been affected by the taking. As indicated, we consider this to be a conservative value, given the decline in revenues which took place in 2004.

The second stage of the valuation process involves the development of an appropriate capitalization rate. As the entire company is involved in the funeral and cemetery industry, we employed the capitalization rate which was previously developed. This process was displayed in Table 3.

Generally accepted principles in the business appraisal industry call for the use of a perpetuity when valuing a business. The calculation of value in that instance is accomplished by dividing the forecast of cash flows by the capitalization rate. As previously reported, our estimate for the complete exhaustion of the sites in Jackson County Cemetery is 19 years. Consequently, it could be argued that the appropriate period for capitalization is 19 years. A closed end capitalization requires the application of the capitalization rate in the form of an annuity. Table 6 displays the calculation of the value of the firm employing both approaches.

The principles of business appraisal clearly require the use of the perpetuity method except when the appraiser has an expectation that the business might not survive as a *going-concern business entity*, as defined in Appendix A (Pratt, Reilly & Schweihs, 1993). Consequently, in our opinion, the fair market value of Jackson County Cemetery, Inc., on March 14, 2004, was $840,000. We consider this to be a conservative value given the use of 2004 data in the calculation of expected cash flows. Our opinion of value for the company includes all assets owned by the company, including real estate, and including the cemetery property.

FAIR MARKET VALUE OF THE COMPANY AFTER THE TAKING

In foregoing sections of this appraisal, we have detailed the calculation of lost cash flows which resulted from the taking of the property. To determine the value of the firm after the taking, those revenues must be subtracted from its expected revenue stream to find revised net cash flows. To accomplish this, we examined the average gross profits and the average overhead costs from Table 5. The difference between these is the net cash flow for the company.

Table 6: Calculation of the Value of the Firm Before the Taking		
Value of the Company Employing an Annuity Approach for 19 Years		
Forecast of Annual Cash Flows	123,064	
Capitalization Rate	14.67%	
Value of the Company at March 14, 2004		776,628
Value of the Company Employing a Perpetuity Approach		
Forecast of Annual Cash Flows	123,064	
Capitalization Rate	14.67%	
Value of the Company at March 14, 2004		838,880
Our Opinion of the Fair Market Value of the Company at March 14, 2004		840,000

As displayed in Table 7, we examined the value of the firm from both an annuity approach and a perpetuity approach. In both cases, we calculated the net present value of the expected annual gross profits, and adjusted those by subtracting the value of the lost cash flows. Then, we subtracted the net present value of the expected annual overhead expenses to find the value of the firm after the taking.

As mentioned above, the principles of business appraisal clearly require the use of the perpetuity method except when the appraiser has an expectation that the business might not survive as a *going-concern business entity*, as defined in Appendix A (Pratt, Reilly & Schweihs, 1993). Consequently, in our opinion, the fair market value of Jackson County Cemetery, Inc., on March 14, 2004, after the taking of the property was $454,000. We consider this to be a conservative value given the use of 2004 data in the calculation of expected cash flows. Our opinion of value for the company includes all assets owned by the company, including real estate, and including the cemetery property, except for the value of the cemetery sites taken by the Department of Transportation.

Table 7: Calculation of the Value of the Firm After the Taking		
Value of the Company Employing an Annuity Approach for 19 Years		
Net Present Value at March 14, 2004, of the Average Gross Profit	5,453,808	
Less the Net Present Value of the Lost Cash Flows	384,874	
Net Present Value of the Adjusted Gross Profits	5,068,935	
Less the Net Present Value at March 14, 2004, of the Average Overhead Costs	4,677, 180	
Value of the Company at March 14, 2004		391,754
Value of the Company Employing a Perpetuity Approach		
Net Present Value at March 14, 2004, of the Average Gross Profit	5,890,968	
Less the Net Present Value of the Lost Cash Flows	384,874	
Net Present Value of the Adjusted Gross Profits	5,506,094	
Less the Net Present Value at March 14, 2004, of the Average Overhead Costs	5,052,088	
Value of the Company at March 14, 2004		454,006
Our Opinion of the Adjusted Value of the Company at March 14, 2004		454,000

FAIR MARKET VALUE OF DAMAGES TO THE COMPANY

The difference between the value of the company before the taking and the value of the company after the taking produces a fair market value of the property which was taken. Table 8 displays our calculations. In our opinion, the fair market value of the 316 cemetery sites rendered unsalable by the North Carolina Department of Transportation on March 14, 2004, is $386,000, and that is the amount of the damages which the eminent domain action inflicted on the Jackson County Cemetery, Inc.

Table 8
Calculation of the Value of the Property Taken

Value of the Company Before the Taking	
Fair Market Value of the Company at March 14, 2004	840,000
Value of the Company After the Taking	
Fair Market Value of the Company at March 14, 2004	454,000
Difference in the Values	386,000
Our Opinion of the Value of the Property Taken at March 14, 2004	386,000

We consider this to be a conservative appraisal because it does not take into consideration rising prices in the cemetery. As fewer sites become available, the price per site will clearly rise. This appraisal holds all prices constant.

We certify that the opinions contained in this report are ours and that we have conducted the investigations and inspections which we considered necessary to arrive at an opinion of fair market value under the circumstances. Further, all the computations and calculations contained in this report are our own, and we have not relied upon the work or opinions of others in arriving at these conclusions.

EPILOGUE

We were very excited about the prospects of going to court and testifying to these findings and attempting to persuade the court that a different standard of value was appropriate when eminent domain actions impacted businesses. Three days before the trial was scheduled, we were deposed by the attorney representing the North Carolina Department of Transportation. He asked a number of questions relating to our approach to the valuation. One issue he presented related to the number of grave sites actually affected by the taking. We had used the number, 316, provided by the client firm, and his evaluation indicated that only 250 grave sites were destroyed. This was not an issue upon which we could express an opinion, as it involved the physical space required for a grave site. This is not a simple determination, as the size of a site varies depending upon whether the site is for an adult or a child, and depending upon whether the site adjoins a family member or not. We were confident that our methodology was strong regardless of the determination of the actual number of sites lost, however, and talked about the damages per site.

We left the deposition feeling confident that we were going to have an opportunity to present a strong argument for a new method of appraisal in cases of this type. That was not to be. The opposing attorneys struck a deal that very day, and settled the case out of court. The North Carolina Department of Transportation paid our client $250,000 for the land taken. This was based upon a value of $1,000 per grave site for the 250 sites which the State deemed unsalable.

Our client and his attorney felt that we had won a great victory, because the settlement was 10 times the original purchase price. We left the courthouse feeling distressed that many entrepreneurs in the future will have to fight this same battle when eminent domain actions take some vital part of their land and business.

REFERENCES

AICPA Standards on Consulting Services (1991). Washington, DC: American Institute of Certified Public Accountants.

Black & Isom Associates (1995). *Business Valuations: Fundamentals, Techniques and Theory.* Salt Lake City, UT: The National Association of Certified Valuation Analysts.

Bureau of the Census (2006). Retrieved from http://quickfacts.census.gov/qfd/states/37000lk.html on March 29, 2006.

Carland, J.W. & L.R. White (1980). Valuing the Small Business. *Journal of Small Business Management, 18(4),* October, 40-48.

Carland, J.W., J.A. Carland & C.D. Aby (1990). Small Business Goodwill: A Pragmatic Valuation Approach. *International Journal of Management, 7(3),* September, 327-331.

CIA World Fact Book (2005). Retrieved from http://www.cia.gov/cia/publications/factbook/geos/us.html on March 31, 2006.

Desmond, G.M. (1994). *Handbook of Small Business Valuation Formulas and Rules of Thumb.* Camden, ME: Valuation Press.

Miles, R.C. (1984). *Basic Business Appraisal.* Boynton Beach, FL: Southeast Business Investment Corporation.

NACVA Standards (1996). Salt Lake City, UT: National Association of Certified Valuation Analysts.

National Association of Certified Valuation Analysts (1998). *Professional Standards*. Salt Lake City, UT: National Association of Certified Valuation Analysts

Ninker, R.W. (2002). "What is your cemetery worth," *International Cemetery & Financial Management*, May.

Pratt, S.P., R.F. Reilly & R.P. Schweihs (1993). *Valuing A Business: The Analysis and Appraisal of Closely Held Companies (Third Edition).* Chicago: Richard D. Irwin, Inc.

Pratt, S.P., R.F. Reilly & R.P. Schweihs (1996). *Valuing Small Businesses and Professional Practices (Second Edition).* Chicago: Richard D. Irwin, Inc.

Revenue Ruling 59-60 (1959). Washington, DC: Internal Revenue Service.

Shipper, D. & A. Bolli (1999). "How much is it worth?" *International Cemetery & Financial Management*, January.

Shipper, D & A. Bolli (1999). "How much is it worth? Part 2" *International Cemetery & Financial Management*, February.

U.S. Treasury (2006). Retrieved from www.ustreas.gov/offices/domestic-finance/debt-management/interest-rate/yield_ historical_2004.shtml on March 29, 2006.

Ward, R.W. (2004). "Where did all those cemetery lots for sale go?" *The Final Arrangements News Journal*, February 15.

APPENDIX A:
DEFINITIONS OF TERMS

Capitalization Rate is the interest rate which is used to convert a stream of future cash flows which are generated by an investment into a single value. The capitalization rate is typically considered to be composed of a risk free interest rate, a premium for risk which takes into consideration the degree of uncertainty as to the realization of the expected future returns including an element reflecting risk evolving from the company, and a premium for the risk of the investment which encompasses both risk of future loss and risk that predicted cash flows may not be realized (Pratt, Reilly & Schweihs, 1996).

Discounted Future Earnings Approach is an income-oriented method of estimating economic value. The approach is used in connection with the estimated future cash flow of a business. (Miles, 1984).

Elements of an Appraisal include: 1) the nature of the business and the history of the company; 2) the economic outlook in general and the outlook of the subject firm's industry in particular; 3) the book value and the financial condition of the company; 4) the earning capacity of the company; 5) the dividend-paying capacity of the company; 6) whether or not the company has goodwill or other intangible value; 7) sales of stock and the size of the block to be valued; and, 8) the market prices of stocks of corporations engaged in the same or similar lines of business as the subject company and whose stocks are actively traded in a free and open market, either on an exchange or over-the-counter (Revenue Ruling 59-60, 1959).

Fair Market Value is the price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts, and both assumed to be able, as well as willing, to trade and to be well informed about the property and the market for such property (Revenue Ruling 59-60, 1959).

Going-Concern Business Entity is a premise for valuation which assumes that the subject firm will continue to operate as an income-producing entity into the foreseeable future (Pratt, Reilly & Schweihs, 1996).

Investment Value Approach is an income-oriented method of estimating economic value. It is applicable to appraising essentially any kind of property whose purpose is to produce income for its owner(s). The approach involves forecasting cash flows which will be generated by an asset or a business, then capitalizing those cash flows at an appropriate rate (Miles, 1984).