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Pittsburg State University

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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.

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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%.

Tom Box
Pittsburg State University

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ARTICLES

ENTREPRENEURIAL APPLICATION OF MARKETING COMMUNICATION IN SMALL BUSINESS: SURVEY RESULTS OF SMALL BUSINESS OWNERS

Joseph R. Bell, University of Arkansas Little Rock
Richard D. Parker, University of Arkansas, Little Rock
John R. Hendon, University of Arkansas, Little Rock

ABSTRACT

The role of advertising in the course of entrepreneurial ventures is largely misunderstood by many academicians, practitioners and small business planners. Yet without a proper understanding of how entrepreneurs and small business owners view and use advertising, those who seek to study this area as well as those whose role in society is to advise and guide those working to develop their own enterprises are navigating without a compass.

This study seeks to address how small business owners in a mid-sized metropolitan area in a largely rural state view and use advertising in their ventures. By utilizing Internet-based surveys the researchers in this project seek to develop a greater understanding of how entrepreneurs and small business owners develop messages, understand target audiences and whether or not advertising is seen as a successful part of their businesses.

INTRODUCTION

Entrepreneurship and Advertising are fields rich in theoretical research, case studies and other forms of scholarship, yet surprisingly little work exists in how these two areas are combined. In order to understand how advertising and entrepreneurship work together one must review literature in separate areas and consider the inclusion of research in retailing, marketing and other related disciplines.

In a 2003 study about advertising and marketing behaviors in small business firms, Harris and Reece found that much literature exists regarding competitive advantage. Yet, despite the wealth of knowledge on this topic, it was “not clear whether small businesses are engaging in marketing and advertising planning” (Harris and Reece, 2003). A study in the *Journal of Small Business Management* found that in fact very little planning of any kind goes into small business activities, yet those who do some amount of planning are less likely to fail (Perry, 2001).

For small businesses to succeed some marketing activities must take place. Small firms can gain advantage over the obstacles to success through the use of appropriate planning activities (Harris and Reece, 2003). One potential reason for the reluctance of some small business owners to engage in any type of advertising may be the perception that advertising clutter could negatively impact their businesses. Ha and Litman found that while there was in fact a negative correlation with advertising clutter the effects were limited to certain vehicles within distinctive advertising media (Ha and Litman, 1997). Other studies (e.g. Lohse, 1997) suggest that the way ads are designed will impact how consumers pay attention to them. Yet one thing is abundantly clear: businesses that fail to engage in some form of marketing to promote their businesses will eventually fail.

While some entrepreneurs may feel that money spent on advertising is wasted, evidence shows that consumers often value advertising that is believable, credible and ethical (Ducoffe, 1995). Given that many entrepreneurs are ethical individuals who wish only to succeed in their business ventures, advertising that is seen as good (believable, credible and ethical) would seem to be an important element in small business strategy. One growing enterprise among entrepreneurs is in the area of service retailing. Given the number of individuals starting businesses that offer services over goods, advertising will be an essential key to the success of those types of businesses. In their 1995 study Stafford and Day found that advertising which is both informative and rational works best for service retail firms; but how many business owners specializing in this area are aware of this?

Many experts acknowledge the fact that the greatest marketing challenge facing small business owners is limited resources for effective advertising (Lippitt, 1995; Harris and Reece, 2003). Other experts (e.g. McCarthy, 1999) suggest that effectively written and placed advertisements will have a positive effect on business growth. A 1984 paper by Dart & Pendleton even suggests that advertising agencies have a means to act as both educator and facilitator to small business owners, yet given the high fees often charged by these agencies many entrepreneurs may feel as

if they are at a disadvantage for using the services of an ad agency (Dart & Pendleton, 1984).

The issues we seek to address in this study relate to how, why and by what means small businesses owners are using advertising in their businesses. We also seek to address attitudes relating to whether or not small business owners feel that advertising is a successful component of their businesses.

RESEARCH DESIGN

An Internet survey instrument was developed by the researchers and placed on-line with assistance from the Arkansas Small Business Development Center (ASBDC). Prior to the on-line placement of this survey three email messages were written and sent to clients, small business owners and entrepreneurs, who had registered with ASBDC. The researchers provided ASBDC with text of the email messages and the ASBDC contacted persons via email regarding this study. The first email was sent a week before the survey was available to potential respondents. The second email was sent when the survey was available and requested that potential respondents complete the survey. The third email was sent the following week as a reminder that the survey was on-line and available for responses.

Potential survey respondents were assured of confidentiality and anonymity in accordance with Institutional Review Board guidelines. Participation was strictly voluntary among those contacted by the researchers. No incentives for participation were offered by the researchers or ASBDC. The researchers are wholly unaware of the identities of the respondents nor are the researchers personally involved with any respondents of this study.

Respondents had the opportunity to review and complete a 31-item survey instrument. Items one through four requested that respondents provide financial information (within predetermined ranges) regarding approximate advertising expenditures for years 2004, 2005 and estimated expenditures for 2006 and 2007. Items five through nine dealt with efforts involved with advertising and media planning. Items 10 and 11 addressed why and how small businesses advertise. Items 12 through 20 sought demographic and psychographic information about the respondents' customers. Items 21 and 22 asked if and how respondents evaluated the success of their advertising efforts. Item 23 employed a 5-point Likert scale designed to measure small business owners' attitudes regarding their perceptions of advertising successfulness. Items 24 through 26 sought to identify in broad terms the types of business respondents were engaged in. Item 27 requested geographic

locations of respondents within the state. Items 28, 29 and 30 sought information regarding length of time in business, number of employees and number of male and female business owners. Item 31 requested information within numerical ranges regarding approximate annual revenues.

The ASBDC has a state office located in Little Rock and six satellite offices dispersed throughout the state. The target list of emails was collected from the client base of all seven offices. The survey was emailed to 400 ASBDC clients that met the criteria of currently being in business and having been a client at some point during the year 2005. Of the 400 emails, 387 were deemed to be valid. A total of 87 survey responses were collected for an outstanding response rate of 22.5%.

RESULTS

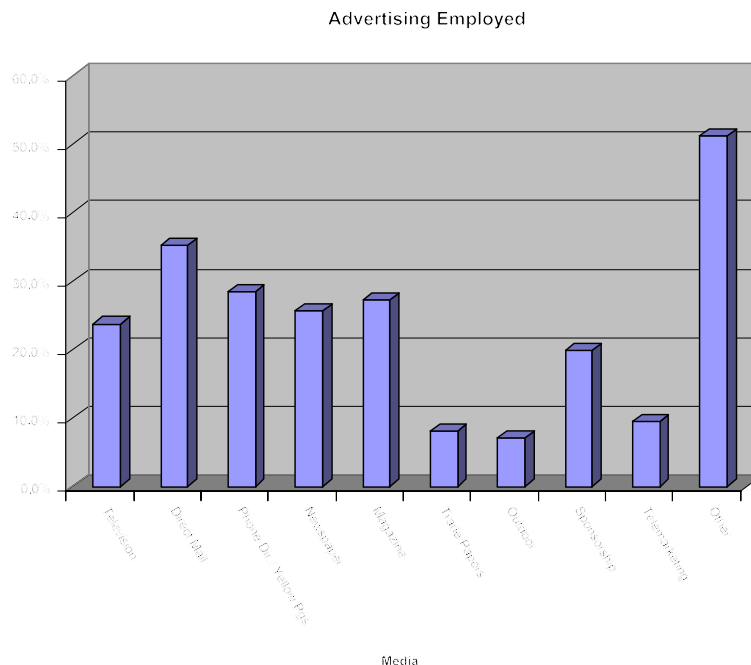
The survey began by assessing advertising expenditures in 2004 and 2005 and anticipated expenditures for 2006 and 2007. In 2004, 58% of respondents spent \$1,000.00 or less in advertising with 30% indicating they spent zero on advertising. Interestingly, in 2005 39% of that same group indicated that they spent \$1,000.00 or less in advertising with 9% indicating they spent zero. In 2006, 32% of respondents indicated that they anticipated spending \$1,000.00 or less and 7% indicated they would spend zero. Again, for 2007 those expecting to spend \$1,000.00 or less dropped to 28% and 8% indicated that they would spend zero. It is noteworthy to mention that those who indicated they would spend \$10,000.00 or more on advertising grew from 14% in 2004 to 17%, 25%, and finally 26% for the year 2007.

In determining advertising expenditures, 44% indicated that they plan and budget each year for their advertising. Of the survey respondents 22% indicated that they use the same advertising in each year. Only 16% said that someone would contact the business and offer them an advertising deal or opportunity.

Of the 87 total respondents only four (5%) indicated that they use an advertising agency to plan their advertising campaign. Of the remaining 95%, 44% selected "price or expense" and 37% selected "we know our needs best" as the primary reasons for not utilizing the services of an advertising agency.

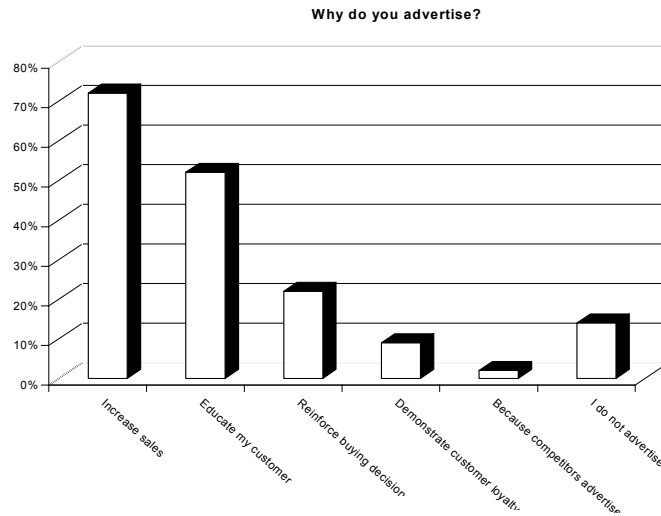
The survey provided ten different categories from which to select the type of advertising media they employ. Respondents were allowed to select multiple categories and 81 of the 87 respondents completed this question on the survey. The responses to this question are listed in the table below. It should be noted that 51.3% selected "Other" but the survey neglected to allow for write-in responses

under this category. It should also be noted that the survey neglected to include radio as one of the responses. When asked what types of advertising media they employ, 35.2% of the respondents indicated they use direct mail, representing the number two response after the “Other” category.



In response to the question, “Do you use press releases to inform the media of changes to your business?”, 32% said “Yes” while 68% responded “No”.

Seventy-two percent of respondents indicated they use advertising to increase sales while 52% of the group said they use it to educate their customers. It was interesting to observe in the “Other” category that two respondents specifically discussed creating brand recognition.

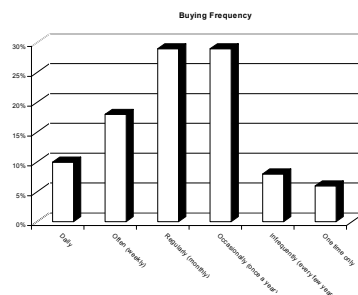


The next phase of the survey begins to look at the advertising relationship between the respondent and their customers. The follow-on analysis to this paper will attempt to define the level of understanding the respondents have of their target customer and the advertising they employee to reach that customer.

The next question examined the motivation of the particular type of advertising employed by the respondents. Only 17% of the respondents indicated that they use a “comprehensive advertising strategy”, with “lowest cost alternative” (32%) and “broadest number of people see what we use” (39%) nearly doubling the 17% response.

The next series of questions (12 through 20) saw a drop off in response rates to a low of a single question response of 37 out of 87 potential respondents. Of 46 respondents, 37% indicated that their typical customer was male, 39% female and 24% were families. Surprisingly, of 43 respondents, 72% indicated that their typical purchaser was between the ages of 31 and 50. Only 12% responded that their customer was 50 years or older even though that portion of the population represents nearly 30% of the total. Respondents indicated that 59% (23 - raw number) of the time females make the buying decision for their product while 41% (16 – raw number) of the time the decision is made by a male (39 responses) And in raw numbers, 21 said that a female ultimately uses their product while 16 said a male would ultimately use the product (37 responses) and 86% of the time and the product is used by an adult (44 responses).

And when asked how often your customer buys from you the responses varied widely. This particular question had a total of 51 respondents.



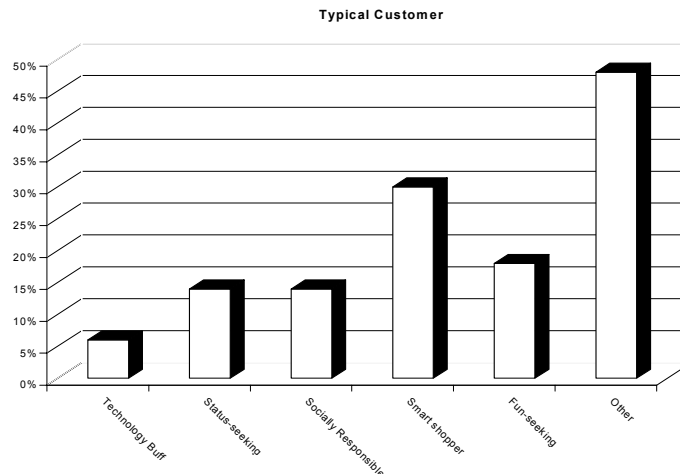
Again, attempting to get an idea of the respondents understanding of their typical customer or target market, respondents were asked about their customers' income profile. Once again, this question had a total of 50 respondents. Of the 50, eleven indicated that they had no idea as to what their customers' income level might look like. Therefore, of the 87 total potential respondents to the overall survey, less than half (44.8%) indicated and that they have a general income profile of their customer.



When looking at the typical customers' occupation level it broke down nearly evenly between White-collar (56%) and Blue-collar (48%) workers (respondents were allowed to select multiple answer choices). Interestingly, 6% of the total 50 respondents indicated that their typical customer was "non-working". Though much of Arkansas is rural there is a significant representative portion that is rather affluent, to the point where respondents were able to single out this particular category of target customer.

The final question in this group attempted to identify the typical customers' profile. There were again 50 total respondents to this question. This section was

particularly interesting in that 24 of the 50 respondents selected “Other”, and 23 of those respondents more specifically described their customer. Entries included “children”, “needle workers”, “wheelchair patients”, “Hispanics”, “working mothers”, “Razorback fans”, and the list continued.



The next three questions dealt again specifically with advertising. We first asked if they evaluate each method of advertising they use. A remarkable 55% said they did not. The remaining 45% said that their method of tracking varied widely from the merely asking customers how they found out about the business or products to using spreadsheets and on-line monitoring. The vast majority indicated it was generally through conversation with customers or just looking at how sales may have moved, though no specifics in regard to timeframe or methodology was indicated.

Respondents were also asked about their perceived success regarding the advertising they employ. Sixty-eight percent indicated the advertising they employ was either “Useful” or “Very Useful”. The remaining 32% indicated the advertising success was either “Neutral” (26% - 23 raw number) or “Useless” (6% - 5 raw number) while no one selected “Very Useless”. This question will obviously play a key role in the follow-on assessment addressing the connection between the advertising employed and the target customer.

The last series of questions (24 through 31) attempted to establish a demographic profile of the respondent businesses. All 87 respondents were comfortable with placing themselves in one of four categories in regard to business

type which included Manufacturing (10%), Service (49%), Wholesale (3%), and Retail (37%). The next question dealt with business sector, with responses spread across 13 potential categories and only one receiving no responses (Infrastructure). Once again, "Other" was the most popular category, receiving 41% of the responses. Respondents in this particular area indicated specifically in what industry their business participated. The second most common response was Retailers/ Consumer Products at 25%, and tied for third, were Technology and Construction at 7%. A number of responses in the "Other" category at some points could be well allocated into the list of the twelve other options. This could affect the percentages as they are currently listed.

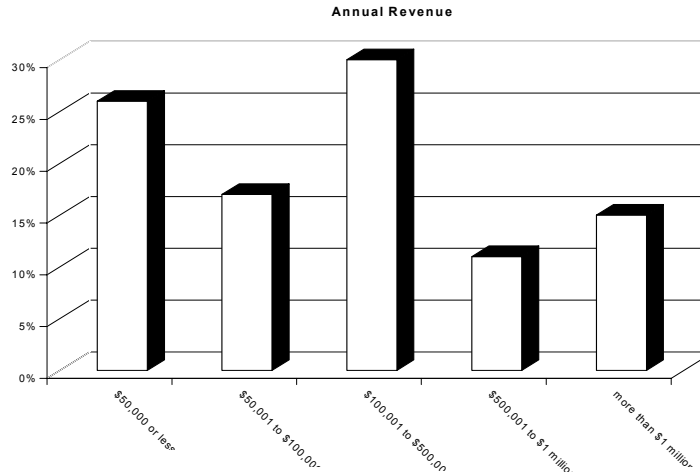
Question 26 asked the 87 respondents to specifically list in what type business they participated. All 87 respondents completed this question. The responses are expectedly varied as in any marketplace. This is somewhat indicative of the prior question and response dispersion regarding "Type of Business". When responding to the question of where the business was located, the highest frequency response was the Greater Little Rock area, but equally impressive was the survey's representation of both rural and urban areas of the state.

When asked how long the respondent had been in business, the average among the 87 respondents was 7.7 years. Four of the respondents had been in business less than one year while one of the respondents had been in business for 55 years. The average number of employees was 9.2 ranging from zero to 75. Interestingly, 57 of the 87 respondents indicated that they had a female as a principal owner or co-owner in the business. This represents over 65% of the respondents.

The final question in the survey dealt with annual revenue. A bit of a bell-shaped curve slightly weighted on the \$50,000.00 or less side was noted when the results to this question were plotted. It will be of interest to note what type correlation might be indicated between advertising expenditure and annual revenue.

DISCUSSION

The design of the questions, and the data collected as a part of this survey, was an attempt to identify how well-versed business owners are in regard to allocating finite advertisement dollars, and specifically targeting those dollars in the most cost effective and audience specific manner.



Though on the surface it does not appear that any of the responses are totally surprising there are a number of issues that need to be further examined. One of those issues is that 28% of the respondents were planning to spend \$1,000.00 or less on advertising for the year 2007. Though over the years surveyed, the percentage of those businesses allocating \$1,000.00 or less has steadily declined, the number appears to be surprisingly high. There also appears to be a disconnect between the businesses' perceived level of advertising planning and their depth of knowledge in regard to their target customers.

It was also somewhat surprising to have 37% of the respondents indicate that they knew best what type of advertising could benefit their business. This is further complicated by 32% indicating that they selected their advertising based on the "lowest cost alternative" while 39% said that they used advertising that reached the "broadest number of people".

It was very surprising to see the significant drop in response rate when the respondents were asked to describe the typical customer. Questions 11 through 20 specifically dealt with the respondents' understanding and knowledge of their customer base. Interestingly, the response rate to the first ten questions was 100%, and again beginning with question 21 through the final question, the response rate was 100%. It would appear that a significant portion of the respondents were either unaware or uncomfortable with describing their customer. If the response rate had dropped-off insignificantly, this may not be a major observation. But because of the significant drop-off rate for only these select questions, it can be assumed that many of the respondents do not understand their target customer. And this may also be

reflected in the fact that 32% of the respondents indicated that their impression of the success of their advertising campaign was either “neutral” or “useless”.

The survey was very encouraging in regard to the overall response rates and the broad dispersion of respondents across businesses and industries. And though it was interesting to observe that an average of time in business was 7.7 years, a rather successful group of respondents, some additional time and analysis needs to be allocated, as a few long lived businesses could well have skewed the results. And again, the 65% female participation in the business as a principle seems to be a little high in regard to what the national numbers may actually look like.

IMPLICATIONS FOR FUTURE RESEARCH

The future research implications will involve an assessment and analysis of the survey data to attempt to gain a better understanding of the current advertising practices of the 87 respondents in regard to their knowledge and understanding of their target market. The intent will be to assess the respondents’ ability to identify and target their advertising and public relations allocation.

Additional opportunities are being explored with Canadian researchers who could possibly administer the survey in a similar fashion to Canadian businesses. Upon the conclusion of their survey the researchers would hope to perform a comparison of the US and Canadian data to be published in a joint paper.

SUMMARY AND CONCLUSION

The purpose of this study was to gain a better understanding of the knowledge and practice small business owners and entrepreneurs exercise over their marketing and advertising choices. While it appears that the survey respondents are willing to in fact spend money on advertising, it is not clear that they are wholly aware of the best use for their advertising expenditures. Also given the number of responses regarding target audience profiles, it is clear that a number of survey respondents are unable or unwilling to describe their customers. If the former is the case, then entrepreneurs and small business owners are gambling with the future success of their endeavors. Without knowing who to target messages to, they will not be able to use advertising effectively in the future.

Our study has sought to better understand the advertising practices of small business ventures. With the knowledge gained here, it is our hope that academics, practitioners and consultants may use this information in providing superior

guidance and expanding knowledge in the interactive area of entrepreneurship and advertising. The potential for future and duplicate comparative studies in other geographic or demographic regions is strong and it is our hope that this research will serve as a catalyst for greater awareness in this area.

ACKNOWLEDGMENT

The authors would like to express their appreciation to State Director Janet Roderick and the staff of the Arkansas Small Business Development Center for their significant assistance in administering the survey instrument that was a large part of this research project.

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YOUR EMPLOYEE HANDBOOK: IS IT AN ENFORCEABLE CONTRACT?

John Hoft, Columbus State University

ABSTRACT

The employment “at will” doctrine means that an employee who does not have an employment contract for a specific duration can be discharged for any reason or no reason at all. “At will” is justified as a two way street. It permits either the employee or the employer to sever the employment relationship without incurring liability. Many employers use employee handbooks to communicate policy. In circumstances where the handbook specifies discipline and discharge processes the handbook may be deemed an enforceable contract and modify the “at will” doctrine. The language in the handbook is key. If the terms of the handbook are unequivocal and manifest to a reasonable person that the employer intends to be bound then the handbook may be an enforceable contract. In order to avoid this interpretation, many employers include a handbook disclaimer that disavows contractual intent. A clear and forthright disclaimer will prevent a handbook from being ruled an enforceable contract. Disclaimers, however, must meet certain criteria in order to be effective. The purpose of this paper is to identify the circumstances under which a handbook may be held to constitute an enforceable contract and to discuss the requirements necessary to effectively disclaim contractual intent.

INTRODUCTION.

On November 1, 1989, Wayne D. Norton, an “at will” employee, was discharged by his employer. Before his termination, Norton had been general manager of the Minneapolis office of Caremark, Inc., a pharmaceutical services company. In Minnesota, employment for an indefinite term is considered “at will” and terminable by either party for no reason without legal liability. Mr. Norton’s vice-president said Norton was fired for poor performance. Norton sued his employer over the discharge and won. A jury awarded him \$305,000 in back pay. How could this happen in a state that recognizes that an employer is free fire an

employee at will and for no reason without legal consequences? The answer lies in the treatment afforded the company handbook. In Mr. Norton's case, Caremark promulgated a document entitled Disciplinary Action Guidelines and distributed and explained the policy to him. The Guidelines set forth a process for discharging an employee. Norton's supervisor failed to follow the Guidelines or the discharge process. The court held that the Guidelines were an enforceable contract between the company and Norton and that the company had breached its promise. As a result, Caremark was liable for damages (Norton v. Caremark, Inc., 1994). The issue to be discussed in this article is when the provisions of an employee handbook that is disseminated to employees may modify the "at will" employment doctrine and create duties upon an employer that are not present in an ordinary "at will" employment relationship.

THE "AT WILL" EMPLOYMENT DOCTRINE.

Under the employment at will doctrine an employer may fire an employee for good reason, bad reason, or no reason at all unless prohibited by law or public policy (Monaco v. American General Assurance Company, 2004). Employment for an indefinite term with no specific duration is considered to be "at will" and terminable at the discretion of the employee or the employer without legal consequences (Wojcik v. Commonwealth Mortgage Corporation, 1990). The "at will" employment doctrine is settled law in most states and in the District of Columbia (Autor, 2006). The "at will" employment doctrine is often justified as being a two way street. The rationale is that it permits either the employee or the employer to terminate the employment relationship for any reason without liability to the other (Mizell v. Sara Lee Corporation, 2005). The result of this doctrine is to allow an employer to terminate an employee without fear of a successful wrongful discharge lawsuit (Eckhardt v. Yerkes Regional Primate Center, 2002).

THE EMPLOYEE HANDBOOK.

Over the past two decades many courts have modified the traditional "at will" employment rule when an employer's handbook or policy manual contains language that provides that discharge will occur for cause or only after certain conditions have been met (Meier v. Family Dollar Services, Inc., 2006). The terms of the handbook, however, must set forth discharge procedures in positive and mandatory language in order to be ruled contractual (Nickum v. Village of

Saybrook, 1997). Use of the terms “must” and “will” may likely result in the handbook promises being enforced (Campbell v. Northwestern Memorial Home Health Care/Services, Inc., 1998). Handbook terms that are couched in an informational tone that are discretionary and not promissory will not result in an enforceable contract (St. Peters v. Shell Oil Co., 1996). In the case of mandatory handbook language the fundamental nature of the “at will” doctrine is not changed but courts have ruled that the employer must follow the handbook’s disciplinary and discharge procedures or face litigation for damages (Deutsch v. Chesapeake Center, 1998). The effect of this line of court cases, then, is to place more requirements upon an employer that promulgates an employee handbook containing mandatory discharge procedures than would have existed in the absence of such handbook language.

THE CONTRACT.

The imposition of contractual duties arising from handbook terms is not without structure. The courts have utilized various contract theories to impose on employers the obligation to follow the procedures set forth in their employee handbooks. The three most common contract theories are: unilateral contract; implied contract; and traditional contract. A brief review of these contract theories will be helpful in understanding when handbook language may be deemed to be contractual.

Unilateral Contract Theory

Under the unilateral contract theory a company handbook must first meet certain requirements before it is deemed to be an enforceable unilateral contract. First, the handbook language must be sufficiently definite in its terms to create an offer. Second, the handbook must have been communicated to the employees. Third, the employee must have commenced or continued work after the handbook was disseminated (Duldulao v. Saint Mary of Nazareth Hospital Center, 1987). The key to determining if a contract has been created by the language of the handbook is whether a reasonable employee would believe from such language that the employer guaranteed him certain protections (Meier v. Family Dollar Services, Inc., 2006). In determining if an employee is reasonably justified in understanding that the employer through the language of the handbook has made a commitment the courts look at three factors. One, whether the handbook sets forth general guidelines

or whether the language constitutes a directive. Two, whether the language is detailed or vague. Three, whether the policies are discretionary or mandatory (Kartheiser v. American Nat'l Can Co., 1999). Detailed and mandatory sounding handbook language is likely to form a contract under this theory. Therefore, a handbook that stated that permanent employees "are never dismissed without prior written admonitions and/or an investigation that has been properly documented" was deemed contractual and enforceable against the employer (Duldulao v. Saint Mary of Nazareth Hospital, 1987).

Implied Contract Theory

Under the implied contract theory, the employee must show that the employer's actions or the language of the handbook manifest to a reasonable person an intent to be bound by the provisions of the handbook (Anderson v. Regis Corporation, 2006). Courts find the existence of an implied contract in the circumstances surrounding the employment relationship, including assurances of job security in company handbooks (Huey v. Honeywell, Inc., 1996). Implied contracts arise from the promissory language of the handbook. Thus, a handbook that stated: "...discharges must be approved in advance by the director of employee relations or designees, and are subject to employee appeal through established grievance procedures" was deemed to be unequivocal language that created an enforceable contract (Perman v. Arcventures, Inc., 1990).

Traditional Contract Theory

The third handbook theory that has been held to modify the "at will" employment doctrine assumes a more traditional contract analysis and has been used by courts where the language of the handbook constitutes terms that are (1) definite; (2) communicated to the employee; (3) are accepted by the employee; and (4) where consideration has been furnished by the employee (Norton v. Caremark, Inc., 1994). Usually, acceptance of employment or continuation of employment after the handbook is promulgated is deemed to be acceptance of the handbook offer and sufficient consideration to support an enforceable contract.

Commonalities

The three theories identified above are not exhaustive. Some courts employ standards that seem vague as in the case of New Jersey courts that recognize that the “at will” doctrine can be modified when the language of the handbook is construed according to the reasonable expectations of the employees to whom it is directed (*Schlichtig v. Inacom Corporation*, 2003). An analysis of the more common theories, however, demonstrates certain commonalities. An employee handbook is more likely to be found to be an enforceable contract and modify the “at will” employment doctrine when the language of the handbook is definite; when the handbook is widely disseminated to employees; and when the handbook language manifests to a reasonable person that the employer intends to be bound by the handbook’s provisions (*Anderson v. Regis Corporation*, 2006).

THE DISCLAIMER

In light of the foregoing erosion of the formerly formidable “at will” employment doctrine, many employers include a disclaimer in the company handbook. A typical disclaimer may provide: “This handbook is not an employment agreement, a contract of employment, or a guarantee of continued employment with _____ and/or its subsidiaries, foreign or domestic. Employment with _____ is ‘at will’ which means that you or the Company may terminate the employment relationship at any time”. And, “DISCLAIMER: This employee handbook has been drafted as a guideline for our employees. It shall not be constructed to form a contract between the Company and its employees. Rather, it describes the Company’s general philosophy concerning policies and procedures.” (*Black v. Baker Oil Tools, Inc.*, 1997).

Courts have ruled that a clear and forthright disclaimer, in general, will prevent the handbook’s terms from being deemed an enforceable contract and will afford an employer a complete defense to a suit for breach of contract based on the handbook (*Workman v. United Parcel Service, Inc.*, 2000). The rationale for this rule is that no reasonable employee would believe that the handbook constitutes a promise or contract in light of a clear disclaimer to the contrary (*Boulay v. Impell Corporation*, 1991). Nevertheless, the presence of a disclaimer in the company handbook will not always prevent the handbook from modifying the “at will” employment doctrine or prevent the handbook from being deemed an enforceable

contract. The courts have required that disclaimers meet certain requirements in order to be effective.

INEFFECTIVE DISCLAIMERS

Disclaimers have failed to achieve the desired result in cases where the disclaimers were ambiguous; or, where the disclaimers were not apparent and were essentially “hidden”; or, where the disclaimers were not reasonably conspicuous; or where the disclaimers were not communicated to the employee.

Ambiguity

Ambiguity arises when the employer uses a multitude of documents to communicate company policy. In such cases, the courts have held that while the handbook did contain a disclaimer the employer created ambiguity by providing employees with other policy documents without a disclaimer. The policy documents without a disclaimer were held to constitute enforceable promises that modified the “at will” doctrine. This is especially true when the other policies contradicted the handbook terms (*Allabashi v. Lincoln National Sales Corporation of Colorado-Wyoming*, 1991). Sometimes the handbook and subsequently issued policy papers merely conflict. In such cases a disclaimer in one document will be ruled not to apply to another policy document that contains no disclaimer (*Swanson v. Liquid Air Corporation*, 1989). In an illustrative case involving a disputed lay off, the employer included a handbook disclaimer that its policies were not part of any employment contract. At the same time company supervisory personnel repeatedly assured the terminated employee that lay offs would occur in accordance with the handbook which specified layoff by seniority. When the terminated employee was dismissed without regard to his seniority he sued claiming that the handbook was an enforceable contract which had been breached by the employer. The employer asserted that employee’s job was terminable at will and that the handbook did not amount to an enforceable contract because of the inclusion of a disclaimer. The company lost. The court ruled that supervisory employees modified the disclaimer by informing the terminated employee that lay offs would occur according to the handbook which specified layoff by seniority. Here, the terms of the handbook were enforced despite the disclaimer because of the ambiguity created by the handbook’s terms, the contrary discharge action taken by the employer and the reassurances

given by company supervisory personnel (Clay v. Horton Manufacturing Co., Inc., 1992).

The rule that ambiguities will be construed against the language drafter holds true in handbook disclaimer contests (Long v. Tazewill/Pekin Consolidated Communication Center, 1991). In short, disclaimers must be clear and unambiguous in order to negate the contractual effect of an employee handbook (Johnson v. Nasca, 1990).

Placement

The placement of the disclaimer in the handbook has also been scrutinized by the courts. Faulty placement can occur and defeat the intent of the disclaimer when the disclaimer is not placed in a prominent place in the handbook and could easily be overlooked by a reasonable employee (Perman v. Arcventures, Inc., 1990). The courts have found a disclaimer to be ineffective when it was not distinctly set out separate and apart from the handbook text and is effectively hidden (Long v. Tazewell/Pekin Consolidated Communications Center, 1991). For example, a disclaimer placed on page 38 of a 39 page handbook under a subtopic entitled “Revisions” was criticized by the court (Hicks v. Methodist Medical Center, 1992).

Conspicuity

In order to be effective a disclaimer must be conspicuous. Lack of conspicuity occurs when the disclaimer is of insufficient size or appearance that an ordinary reasonable employee would not see and note its contents. Where a handbook disclaimer was not set off in any way, was placed under a general subheading, was not capitalized and was of the same type size as another provision on the same page it was held to be not adequately conspicuous (McDonald v. Mobil Coal Producing, Inc., 1991). In order to be effective, a disclaimer should be prominently displayed (Hicks v. Methodist Medical Center, 1992), and not buried in a glossary (Durtsche v. American Colloid Company, 1992). In short, the promissory terms of an employee handbook can only be negated by a conspicuous disclaimer prominently displayed in a typeface different from the ordinary text (Wheeler v. The Phoenix Company of Chicago, 1995).

Notice

Failure to show that the disclaimer was communicated to the employee may be fatal to its enforcement. An employer must bring its handbook disclaimer to the personal attention of its employees (*Morriss v. Coleman Company, Inc.*, 1987). For example, when an employer changed its company handbook to include a disclaimer, the handbook also contained a receipt form and a place for an employee signature. The form was to be placed in the employee personnel file. When the disclaimer was contested the employer was unable to produce evidence that the employees had received the new handbook with disclaimer. The employees testified that they were not aware of the changes made to the handbook and were ignorant of the existence of the contract disclaimer. The court ruled that while an employer retains the right to change employee policy if such a change is to be effective it must be communicated to the employees (*Crain Industries, Inc. v. Cass*, 1991).

SUMMARY AND IMPLICATIONS.

The “at will” employment doctrine enables an employer to fire an employee at any time for no reason without fear of legal consequences. “At will” was, and continues to be, settled law in most jurisdictions in the U.S. However, in the past 25 years this bright line rule has begun to dim and has been modified by the courts when confronted with company handbooks that contain mandatory sounding discharge and discipline language. In such cases the courts have frequently found that the terms of the company handbook formed an enforceable contract and that discharge of an employee without following the procedures set forth in the handbook amounted to a species of breach of promise and subjected the employer to a judgment for money damages. Therefore, in order to avoid unintended exposure to liability, the author of an employee handbook should first assure that the language used will not manifest to a reasonable employee an intention by the company to be firmly bound by the policy expressed. Second, the handbook author can include a contract disclaimer to the effect that the handbook terms do not create a contract between the company and its employees. A clear and forthright disclaimer can be a complete defense to a suit for breach of contract based on the terms in an employee handbook. However, in order to be effective, the handbook disclaimer must be forthright; conspicuous; distinctly placed; distinguished from the rest of the text by capitalization or bold face type; and be conscientiously disseminated to all employees who will be subject to the handbook’s terms.

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A MODEL FOR PREVENTION AND DETECTION OF CRIMINAL ACTIVITY IMPACTING SMALL BUSINESS

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ABSTRACT

According to the Federal Bureau of Investigation, the annual cost of business crime activity to the U.S. economy is \$652 billion. Additional costs of litigation and security measures suggest the many forms of business crime significantly impact business. While FBI data does not separate small businesses from large corporations, it appears that small business ventures will be susceptible to criminal activity. In fact, the United States Chamber of Commerce reported that business ventures of less than \$5 million in sales will be 35 times more likely victims of business crime than larger firms. In addition, 30 percent of small business failures resulted from internal crime and employee dishonesty (U.S. Chamber of Commerce, 1995).

This paper examines the extent of criminal activity affecting small business and nonprofit organizations and provides a three-stage model managers can use to prevent, detect, and remedy criminal activity.

INTRODUCTION

Data suggests significant criminal activity in business ventures. Despite improvements in management and auditing procedures, Accounting Information Systems (AIS) software, and advanced computer technology, criminal activity continues to impact businesses at an alarming rate.

Computerization of small business ventures may actually contribute to increased criminal activity. According to the U.S. Small Business Administration, more than \$100 million in losses annually can be contributed to computer fraud

(U.S. Small Business Administration, 2000). In 1995, the United States Chamber of Commerce reported the impact of theft and other crimes on small businesses accounted for 30 percent of small business failures (Holt, 1993). In addition, these criminal activities cost consumers up to 15 percent of total pricing for goods and services (Holt, 1993). The University of Florida conducted a study in 1994 (Donnelly, 1994) and found 42.1 percent of inventory shrinkage could be directly attributed to employee theft and poor record-keeping and shoplifting accounting for an additional 32.4 percent.

Forensic accounting articles often focus on large corporations, rather than small business ventures as the financial impact tends to be greater. However, business ventures of all sizes can be potential targets for crimes including money laundering, intellectual property theft, and embezzlement. According to data from the Federal Bureau of Investigation during 1994-2002, the number of intellectual property theft cases increased 26 percent. Small business ventures are not immune to money laundering as monies may be channeled through the business from an employee or third party. FBI data indicates money laundering offenses will often be coupled with additional felonies such as embezzlement, fraud, or drug trafficking.

Fraud may affect other individuals and businesses in addition to the direct victim. For example, fraud resulting from substance abuse increases law enforcement costs. Other agencies and organizations may be affected as well, including costs associated with drug prevention and rehabilitation, crime prevention and court costs. Other businesses and insurance companies may also be affected as well.

Fraud and other criminal activity cannot be confined to the corporate world. Larimer (2006) finds that although businesses across the United States lose more than \$652 billion to embezzlement and fraud every year, nonprofits and small businesses may actually lose the most. A 2006 report by the Association of Fraud Examiners reports that while the average loss for employee fraud amounted to \$159,000 in 2005, the average loss for businesses with less than 100 employees is found to be actually higher-----\$190,000 (cited in Larimer, 2006).

Additional crimes under the fraud category include identity theft, collusion, corporate fraud, embezzlement, and use of tax haven countries for illegal activities. Some of these crimes may be more common to large corporations, however, due to increased knowledge and use of high technology, specialized auditor training should be initiated and in many cases staff auditors should be trained as forensic accountants (Manning, 2005; Ramaswamy, 2005). Tom Golden, PricewaterhouseCooper's Midwest investigation manager stated that the need for

trained forensic accountants has increased significantly because of recent corporate scandals and media attention (Wells, 2003).

A 1996 study by the U.S. Small Business Administration of 400 small businesses in the six-state area of Michigan, Ohio, Indiana, Illinois, Wisconsin, and Minnesota found 13 percent of businesses experienced at least one crime within the last year. Perpetrators included customer theft, vandals, and burglaries, in addition to employee theft. Many crimes went unreported, and more than half of small businesses did not employ even one protective security measure such as outside lighting, alarm systems, or security cameras (The Small Business Research Summary ISSN 1076-8904).

News articles suggest that fraud activity results in an almost daily event (Gullapalli, 2004). Scandals at WorldCom and Enron devastated employees and investors who relied upon auditors and management (Off to jail, 2005; Schickel, 2005). The importance of auditors being trained to detect fraud methods and in accounting information systems can be noted in New York (Accounting Department Management Report, 2005).

Common Employee Crimes	
♦	Theft (“skimming”) of cash
♦	Theft of inventory-merchandise or equipment
♦	Writing company checks
♦	Falsifying revenue reports
♦	Processing fraudulent invoices
♦	Customer identity theft
♦	Money laundering
♦	Intellectual property theft
♦	Credit card fraud
♦	Overstated expense reports
♦	Payroll fraud (Albrecht et al, 2006)

Marten and Edwards (2005) developed the fraud triangle concept involving three elements including pressure or incentive to commit fraud, opportunity, and rationalization. Background and reference checks can be used to minimize the effects of incentive and rationalization while opportunity can be limited through

other controls such as authorizations, key control, and surveillance cameras. Prevention can be money well-spent, as Kuratko et al (2000) found small businesses spending on average \$7,805 on crime prevention. While this may seem like a significant amount of money, the average loss of \$190,000 will be nearly 25 times the cost.

FINANCIAL FRAUD

In a recent audit of HealthSouth Corporation, PriceWaterhouseCoopers found inaccurate revenue and expense reporting and improper accounting of business activities which resulted in fraud charges (Weld, Bergevin & Magrath, 2004). These improper activities were uncovered by forensic accountants through the use of spreadsheet software to conduct statistical and database analysis. Detailed financial auditing required forensic accountants to thoroughly understand the AIS system to analyze receivables and uncover a connection between cash flow and financial performance measures (Bodnar, 2004; Buckhoff, 2004).

Understanding the elements of fraud can be important for forensic accountants (Buckhoff, 2004). Wolfe and Hermanson (2004) developed the fraud diamond model. This model provides different ways to consider fraud risks which include capability, opportunity, rationalization, and incentive. The authors warned fraud examiners not to underestimate perpetrators as they might take advantage of internal control weaknesses. The authors emphasized the importance of auditor's complete understanding the AIS system. This will be particularly important because small businesses likely use the least inexpensive AIS or spreadsheet software available (Bruckoff, & Kramer, 2005; Derby, 2003; Williams, 1997). Forensic accountants would find a thorough understanding of AIS especially important when conducting a fraud investigation and seeking to determine which employees capable of bypassing and/or removing red flags from the AIS system (Kranacher & Stern, 2004; Weber, 1999).

Background Checks

Although it might seem elementary, background reference checks may be one of the most significant preventive measures a company or organization can take to reduce the likelihood of becoming a victim of employee crime. Sometimes, job applicants misrepresent their education or experience. Recently a company preparing to hire a new financial director found that the applicant background check

revealed he had neither an MBA degree nor the experience he stated (Business Week).

Small companies and nonprofits may be reluctant to use background and reference checks due to the cost and time involved. One study reported that 30 percent of the workforce actually plans to steal from their employers and an additional 30 percent might, on occasion, also be tempted to steal from their employers (Hogsett & Radig, cited in Kuratko, et al). Together, some 60% of the workforce potentially fuels the internal crime problem.

Cyber-Crime Activity

The rate of cyber-crime increases as companies expand computer systems and Internet business activities. According to a 2000 study by the Computer Security Institute, 85 percent of respondents suffered a computer security breach in the previous year (Computer Crime Losses Controller's Report). While the Internet is rapidly becoming the most common point of attack (70%), a significant portion of activity is occurring through accessing computer systems on-site (Computer Crime Losses Controller's Report).

One study by the Computer Research Institute found the greatest financial loss to business security systems due to virus attacks (The CPA Journal). The most significant financial losses can be attributed to unauthorized access to information, particularly proprietary information (The CPA Journal).

Payroll Fraud

According to the Association of Certified Fraud Examiners (AFCE), 39 percent of fraud activity occurs in business with less than 99 employees (Bank Technology News). AFCE warned that small businesses will be particularly susceptible to payroll fraud. One red flag to watch for would be unusual spikes in the number or size of checks written (Bank Technology News).

Wells (2001) provides several examples of how employees use access to payroll as a means to defraud a company. Some of the criminal techniques include setting up payroll for ghost employees, falsified wages, and commission schemes. Wells (2001) further cited an example of an accounting employee who within months embezzled more than \$200,000 as she was the only employee responsible for those accounts.

Forensic Accountant Understanding of AIS & Audit Procedures

Forensic accountants need to be knowledgeable of Accounting Information Systems, the necessary software audit tools, and the AIS software. The importance of audit tools training can be noted in an article by Jackson (2004) which he considered as a necessity for successful forensic accounting. The article cites an example of a faculty member at Boston College, who developed an AIS audit program that triggered additional audit related systems. In addition, the article provided the reader with suggestions for training the forensic accounting staff.

The Association of Fraud Examiners reported some interesting data that might shed light on why fraud is prevalent among small businesses (Colorado Springs Business Journal). First, only 20 percent of internal audit departments conduct surprise audits. Second, less than 10 percent of small businesses possessed anonymous fraud reporting procedures. The AFE reported that businesses not utilizing anonymous reporting procedures suffered losses twice as high as those businesses with anonymous fraud reporting procedures. Larimer (2006) reports that only 30% of fraud cases in small businesses and nonprofits will be prosecuted.

Criminal Activity Investigation

Larger companies note a distinct advantage in criminal activity investigation as they possess resources necessary to carry out investigations. Although smaller companies and nonprofits may not possess an internal audit team, sophisticated technology, computer software, and funding for external audit teams, the cost of employee crime would make it necessary to take extra measures to prevent employee crime. In addition, as nonprofits may be more significantly affected by criminal activities, money spent for prevention and recovery helps insure donor confidence in nonprofit management capability.

Numerous cases exist where nonprofits are victims of employee embezzlement. In California, a church financial manager embezzled more than \$800,000 within a year's time (Larimer, 2006). Another cited example refers to the Cheyenne Mountain Zoo, where the financial controller embezzled more than \$200,000 (Colorado Springs Business Journal). In each of these cases, fellow employees noted the embezzler living beyond their means which can be a fraud red flag (Silverstone & Sheetz, 2007).

Engagements relating to criminal matters typically arise in the aftermath of fraud. They frequently involve the assessment of accounting systems and accounts

presentation - --in essence assessing if the numbers reflect reality. Forensic accountants utilize an understanding of business information and financial reporting systems, accounting and auditing standards and procedures, evidence gathering and investigative techniques, and litigation processes and procedures to perform their work. Forensic accountants also increasingly play more proactive risk reduction roles by designing and performing extended procedures as part of the statutory audit, acting as advisors to audit committees, and assisting in investment analyst research (http://en.wikipedia.org/wiki/Forensic_accounting).

Non-Profits as Targets

Non-profits would be especially vulnerable to crimes such as embezzlement as they tend to be too trusting of their membership and lack the typical control procedures more commonly found in businesses. Numerous cases reported in the news suggest that no non-profit will be safe from potential embezzlers. Reports indicate that in many cases the embezzlers found themselves under financial pressure as a result of difficult financial situations, gambling, or other addictive behaviors (The Georgia Bulletin). Two cases of embezzlement in the Milwaukee area, \$310,000 and another more than \$500,000, could be found fueling the gambling addictions of church volunteers (The Georgia Bulletin).

Researchers at Villanova University surveyed Roman Catholic dioceses across the United States to determine the extent of embezzlement activity affecting the church. Of those dioceses that responded, 85 percent reported cases of embezzlement within the last five years and 11 percent reported cases involving theft of \$500,000 or more (The Kansas City Star). Orrick (2006) reports that one couple, who worked for a suburban sports league stole thousands of dollars before being caught. If the league conducted background and credit checks they would have found the couple had filed for bankruptcy protection with \$216,580 in debt, primarily from medical bills (Orrick, 2006). Another example includes a hockey coach who embezzled \$77,000 from the hockey league to help pay gambling debts (Orrick, 2006).

Third-Party Service Providers

Although a common control procedure could be to hire third-party service providers, particularly for payroll and accounting services, providers may commit crimes against your business, including embezzlement, money laundering, and

fraud. In South Bend, Indiana, (Draeger, 2005) reports that a tax preparer not only stole money from one of his client's bank accounts to use money to pay his own debts, he was charged with embezzling \$13,000 from the local Baptist church where he is a member.

PREVENTION

The first place businesses should start would be to develop sufficient prevention techniques that can deter the occasional person who might be tempted to steal. These methods include employee background, credit, and reference checks. As many embezzlers will steal in order to pay debts or to subsidize addictions, credit checks may be useful method to screen out applicants prior to hiring. Similarly, substance abuse testing might reveal applicants who could potentially steal in order to pay for drugs. One study even noted that employee theft increases just after the holidays when the impact of debt purchasing begins to sink in. Wells (2003) cites a 2002 Association of Certified Fraud Examiners study that indicates as much as 7 percent of the workforce exhibit a history of workplace theft and fraud.

Proper authorization procedures may also reduce the incidence of employee embezzlement. This also includes training authorizers to carefully scrutinize checks and payments, even when presented by trusted, long-term employees. Key control reduces the number of persons to access of cash, checks, equipment, and inventory.

Prevention measures may also protect the business from outside criminal activity. Procedures as basic as adequate facilities lighting can reduce crime. Security guards, alarm systems, surveillance cameras, and checking identification may also be good prevention methods. Remember to protect your computer system with firewalls and only utilize secure Internet payment sites. When customers pay for products and services use a check authorization service and check customer identification for both check and credit card usage.

DETECTION

In the likely event that prevention procedures will not be able to eliminate all potential criminal activity, businesses should also utilize crime detection procedures. Many of these procedures are also relatively simple and inexpensive for the business owner including frequently checking/reconciling bank statements and conducting unscheduled audits. Business owners should also invest in accounting information systems software that provides the user with red flag indicators where there may be

potential problem areas. In addition, using inside and outside auditors serves as a check and balance system to reduce the potential for payroll and other forms of accounting fraud.

One of the typical indicators of embezzlement is a significant change in an employee's lifestyle whereby the employee purchases items that would not be consistent with his or her salary level. A recent example involved a California church, where the financial manager purchased an \$80,000 diamond. When the appraisal certificate was inadvertently mailed to the church, officials became suspicious (Colorado Springs Business Journal). In another case, (Orrick, 2007) investigators found an embezzling couple who purchased an expensive diamond ring and a \$28,000 boat. Police investigators may be especially useful for small businesses and nonprofits as they are experienced in these matters and often possess special training.

According to Yormark, (2004) Sarbanes-Oxley legislation includes provisions that provide employees with additional whistleblower protection. This may encourage employees to speak out when they observe irregularities that might result in new additional fraud investigations. Outsourcing through audit firms or through investigative agencies for more experienced staff members is almost a necessity for smaller firms and nonprofits.

Wells (2003) found that fraud examiners generally possess certain personality traits that include perseverance, aggressiveness rather than shyness, and skilled working with numbers. Upon forming the fraud investigation team, goals should be determined prior to conducting the investigation including the importance of acquisition and properly maintaining evidence (Wells, 2005). It will often be necessary that the forensic accountants gather enough information to support fraud or embezzlement activity (Manning, 2005).

The Role of Forensic Accountants

Forensic accountants must understand and follow the Federal Rules of Evidence-Rule 702 (Craig & Reddy, 2004; Manning, 2005; Rasmussen & Leauanae, 2004; Shmukler, 2005; Wells, 2003; Wells, 2005). Rasmussen and Leauanae (2004) find areas of expertise necessary for forensic accountants in investigative accounting include intangible and business asset valuation and skills in economic loss calculation.

In addition, the authors suggest forensic accountants should possess an advanced or graduate degree. Today's business complexity and rapidly-changing

technology, particularly accounting information systems and audit procedures for conducting fraud investigations, suggests forensic accountants should also be professionally certified. Professional certifications include Certified Fraud Examiner (CFE), Certified Internal Auditor (CIA), and Certified Public Accountant (CPA). An additional certification the investigator might consider is the Certified Insolvency and Restructuring Advisor (CIRA) designation. In addition to the specialized knowledge of a designated certified professional, another advantage to the professional designation is added credibility to the expert witness testimony in court. Bressler and Bressler (2006) report that small business owners rely on the advice of business counselors or consultants in selecting AIS software. Forensic accountants may provide this consultant role in selecting AIS software that provides red flag notices to the business owner of potential fraud activity.

REMEDIES

One of the most important remedies will be to contact the police and prosecute the offenders. Unfortunately, some small businesses and more often nonprofits can fail to do so. In the case of the nonprofits, the offender is often a respected and well-liked individual. This may send the wrong message, and donors may consider a nonprofit less credible as they cannot properly manage their finances. Courts may also be able to require the offender pay restitution.

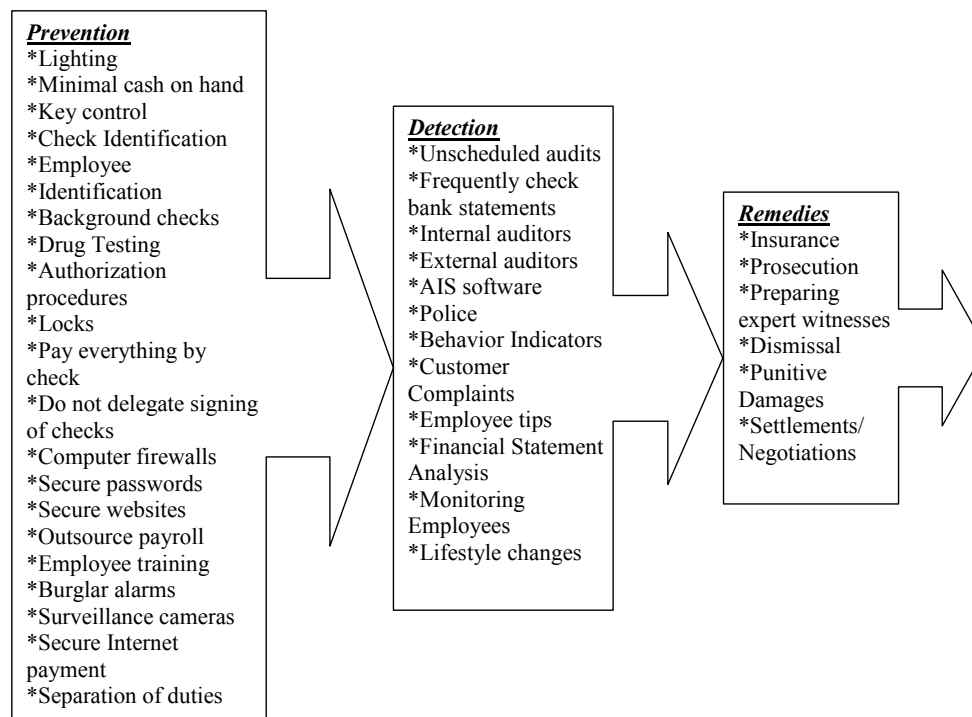
The role of forensic accountants is critical at the remedy stage, as they are the expert witnesses the prosecution calls upon to provide testimony how the offender stole from the company or organization. As witness testimony will most likely be challenged in court, forensic accountants must be trained in audit investigation techniques, possess appropriate professional certifications, and be prepared to present detailed evidence that will hold up under cross-examination.

The final remedy is insurance. However, many small businesses are uninsured or underinsured when criminal activity occurs. According to a 2002 study by the National Federation of Independent Business, 15% of small business owners do not purchase business insurance at all (National Federation of Independent Business). Those who do are more likely to carry coverage for property damage, worker's compensation, and premise liability, only 34% carry business interruption insurance (National Federation of Independent Business).

Some of the types of insurance recommended by the U.S. Small Business Administration include general liability insurance, product liability, home-based business insurance, Internet business insurance, worker's compensation insurance,

criminal insurance, business interruption insurance, key person insurance, and malpractice insurance (U.S. Small Business Administration, Small Business Planner).

A Three-Stage Model for Prevention and Detection of Business Criminal Activity



IMPLICATIONS

Results of this study provide important implications both for academics as well as business owners. For academics, there will be ample opportunity to further explore awareness levels of business owners regarding criminal activity and prevention methods, especially those criminal activities that are computer or Internet

based. In addition, research might provide interesting case analyses in fraud prevention and detection that could be applied in other businesses.

This research also provides some important implications for small business owners and nonprofit organizations. Costs and rising insurance premiums are cited as a major factor for small businesses not purchasing business insurance (National Federation of Independent Business). For business owners, insurance and prevention cost may not be as significant when compared to potential costs of criminal activity. In addition, business owners and nonprofits might need to re-think trust levels in employees and volunteers. In the case of many nonprofits, embezzlers worked with the organization for fifteen or more years and had established a high level of trust. At the very least, organizations may need to follow sound business procedures to safeguard assets and in addition, become more observant of employee/volunteer behavior.

CONCLUSION

As can be noted in the above model, businesses and nonprofits are able to develop many prevention techniques to limit their exposure to criminal activity (Albrecht et al (2006). Prevention, however, does not prevent every occurrence of criminal activity. Prevention must be coupled with an on-going series of detection capabilities to minimize crime impact. Finally, nonprofits and small businesses will often be uninsured or under-insured. Adequate insurance may safeguard small businesses from becoming one of the estimated 30% of small business that fail due to criminal activity.

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ON THE THEORY OF PSYCHOLOGICAL CONTRACTS IN FAMILY FIRMS

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ABSTRACT

Issues of fairness, justice, trust, integrity, and agency relationships are widely discussed in the family business literature as they relate to family member and non-family member employees. To date, however, psychological contracts have not been utilized to address the obligations between employees and the family firm. Psychological contracts are individual beliefs in a reciprocal obligation between the individual and the organization including perceived promises, valued payments, and acceptance of exchanges. Examining psychological contracts in family firms is essential in light of these two unique groups. This paper addresses the topic by providing a theoretical model of the role of psychological contracts in family firms supported by propositions. We believe this provides a more comprehensive approach to issues such as fairness, trust, and justice because of the element of reciprocity, where mutual and cooperative relationships are examined.

INTRODUCTION

With more than two-thirds of all organizations being family owned and/or managed (Gersick, Davis, Hampton, and Lansberg, 1997), it is essential to examine the management practices within those firms. Furthermore, it is important to determine the impact of specific human resource practices on performance, as illustrated by Astrachan and Kolenko (1994), who empirically examined the human resource practices in 600 family owned businesses. Their findings suggest that the effective use of HR practices provides a competitive advantage in the marketplace, particularly showing positive correlations with gross revenue and CEO personal income levels.

This paper aims to provide a theoretical model for examining the role of psychological contracts in family firms, more specifically focusing on two unique groups, family and non-family members. Psychological contracts are individual beliefs in a reciprocal obligation between the individual and the organization (Rousseau, 1989). A review of the literature is provided, first on human resource practices in family firms and then on psychological capital, which centers on the definition, contract formation, and contract fulfillment. The theoretical model is then introduced supported by our propositions and followed by a conclusion and call for empirical research.

LITERATURE REVIEW OF HUMAN RESOURCE PRACTICES IN FAMILY FIRMS

Many family-owned businesses must rely on non-family member employees to operate and be successful. Thus, a significant challenge family-owned businesses face is effectively managing non-family members (Chua, Chrisman, & Sharma, 2003). This includes attracting and retaining high quality employees who contribute to the success of the firm and other typical HR processes such as staffing, compensating, conducting performance appraisals, applying company policies and procedures, and granting promotions. Furthermore, Corbetta and Salvator (2004) assert that family firms must implement HR practices that provide non-family members with a strong sense of psychological ownership. Therefore, it is not only imperative to assess HR practices in a general sense, but also as they relate to two unique groups, family and non-family members.

As Mitchell, Morse, and Sharma (2003) contend, non-family members may oftentimes find themselves in complex and uncertain situations because they are part of the business system but not the family system. What leads to the uncertainties and complexities stems from a variety of issues such as how decisions are made (Blondel, Carlock, & Heyden, 2000), a perceived environment of bias and favoritism (Schulze, Labatkin, & Dino, 2003; Lubatkin, Shulze, & Dino, 2005), the direct involvement and influence of family members (Astrachan, Klein, & Smyrinos, 2002), as well as fairness and procedural justice issues (Cropanzano & Greenberg, 1997; Barnett & Kellermanns, 2006).

While James (1999) finds that explicit formal contractual relationships (i.e. written agreements) can be more effective in family firms than implicit informal relationships (i.e. unwritten agreements), the latter of the two always exists where

issues of fairness and trust may be more prevalent, especially in firms where non-family members lack “status” in the family system. This status disparity could lead to “ingroup-outgroup” perceptions such as questioning the trustworthiness and fairness of the family business system and/or individual family members (Barnett and Kellermanns, 2006).

Issues of trust, integrity, and fairness have been addressed in the literature as they relate to family firms, especially on the topic of succession management. For example, Steier (2001) contends that while trust in those holding positions of authority plays an important role in any organization, it actually provides family firms a unique competitive advantage because it is so indigenous in the relationships that exist. Once a firm grows and succession management occurs, trust becomes an even more important coupled with effective communication (Morris, Williams, and Nel, 1996). In a similar vein, an empirical study by Chrisman, Chua, and Sharma (1998) found that integrity rated among the most important attributes of a successor in family firms.

While issues of fairness and justice have been addressed in family business research (Baldrige & Schulze, 1999; Blondel, et. al, 2000) as well as trust and integrity (Steier, 2001; Morris, et. al, 1996; Chrisman, et. al, 1998) in addition to agency relationships (Corbretta & Salvato, 2004; Schulze, et. al, 2003a; Schulze, et. al, 2003b; Schulze, et. al, 2001), psychological contracts have not yet been examined. Our paper presents a theoretical model and propositions to address psychological contract formation and fulfillment in family-owned businesses. Specifically, we suggest how non-family employees may form contracts different from family members, how mutuality and reciprocity affect contract breach, specific factors that moderate the contract breach-violation relationship, and the ultimate effect that contract violation can have on the success and sustainability of family firms. Included in Appendix A is our model of the role of psychological contracts in family firms.

LITERATURE REVIEW ON PSYCHOLOGICAL CONTRACTS

In this section we introduce the concept of psychological contracts by providing a discussion of the definition and important elements of contract formation and fulfillment. We also discuss how they may play out in family firms.

Psychological Contract Definition

Psychological contracts are individual beliefs in a reciprocal obligation between the individual and the organization (Rousseau, 1989). A psychological contract includes a perceived promise, a valued payment, and acceptance of the exchange (Rousseau, 1995). A promise occurs when the employee perceives the existence of a reciprocal obligation with the employer even if the employer does not recognize that obligation's existence. Psychological contract advocates state that perceived promises greatly affect employees because promises are associated with an immense sense of commitment (Rousseau, 1989, 1995; Rousseau & McLean-Parks, 1993). A payment occurs when the organization fulfills the perceived obligation by offering a reward valued by the employee. Acceptance of the contract occurs when employers and employees voluntarily participate in perceiving, developing, and rewarding promises and are held accountable to each other for the perceived fulfillment of those promises. The psychological contract process involves how employers and employees form contracts, what contributes to perceptions about the fulfillment of the contract, and how fulfillment and non-fulfillment of a contract affects organizational success. To gain a thorough understanding of the important role that psychological contracts play in family firms, our paper will develop a model that addresses each step of the process.

Psychological Contract Formation

An employee can develop four different types of contracts based on his or her perceptions of the reciprocal promises included in the psychological contract (Rousseau, 1995). A transactional contract exists when performance is specified and the employment relationship is short-term. Rousseau (1990) found that transactional contracts are generally characterized by monetary focused exchanges for a brief, specific performance. Relational contracts occur when the employment relationship is long-term with ambiguous performance requirements. Relational contracts have been found to include monetary and non-monetary aspects that focus more on the long-term exchange (Robinson, Kraatz, & Rousseau, 1994). Transitional contracts result when employment is temporary and performance is not specified. Balanced contracts, like relational contracts, exist when employment is continuing but unlike relational contracts performance requirements are known. See Figure 1

Psychological contract formation can be influenced by a number of different variables. For example, the type of psychological contract a person forms can be greatly influenced through the recruiting process ENRfu(Shore & Tetrick, 1994). When a person engages in various aspects of the recruiting process, both the employer and prospective employee provide explicit and implicit messages about the employment relationship. For small family firms, the recruitment process can be expensive both in time and money. Having a transparent recruitment process with realistic job previews can diminish the recruiting costs while increasing the opportunity that the employee will form a psychological contract that aligns with the employer's expectations for the employment relationship.

Figure 1: Psychological Contract Formation *

	Short-term Relationship	Long-term Relationship
Specific Performance Requirements	Transactional	Balanced
Ambiguous Performance Requirements	Transitional	Relational

* Adapted from Rousseau, D. (1995), p. 98.

Another influence is the employment goals that the prospective employee has for the employment relationship (Shore & Tetrick, 1994). Both employers and prospective employees have expectations about the length of the employment relationship. In family-owned businesses family members are more likely to have a long-term commitment to the organization, and because of the familial ties, are more likely to form relational or balanced contracts. However, a non-family prospective employee is not bound by familial ties and may have any number of expectations for the employment relationship. An employee who has accepted employment with the goal of a short-term commitment would be more likely to form a transitional contract than an individual who wants to retire with the hiring

organization. That person would be more likely to form a relational or balanced contract.

How information is communicated and processed during the recruitment process can influence an individual's psychological contract formation (Shore & Tetrick, 1994). In particular, this involves how the individual inquires and interprets information about the employment relationship. Many individuals will often rely on incomplete information when making decisions. The amount of incomplete information that a prospective employee is willing to accept can influence the type of psychological contract formed. If an individual has very incomplete information about the employment relationship, then he or she might form a very different contract than if more complete information had been available. Also, if any negotiation occurs during the recruitment process, how the prospective employee engages in the negotiation process and the resulting outcomes can influence the type of contract the individual forms.

Rousseau (2004) identified the role that a person's personality can have when forming a psychological contract. According to Rousseau, individuals highly sensitive to organizational justice issues or may have neurotic tendencies are more likely to form transactional contracts; whereas, individuals with high conscientiousness and self-esteem may form more relational based psychological contracts. Oftentimes, organization-person fit is important for family firms because family and non-family employees may work very closely together. Understanding what type of personality family members seek in non-family members can also give insight to the potential psychological contracts that non-family members may form.

Psychological Contract Fulfillment

All employers and employees form psychological contracts whether they realize and acknowledge them or not. Therefore, it is necessary for the family business owners to understand the significant role that fulfilling these contracts can have on the level of trust within the employment relationship and, ultimately, the organization's performance.

Dabos and Rousseau (2004) identified the important effects that perceived mutuality and reciprocity have on psychological contract fulfillment perceptions within collaborative work environments. Their research found that mutuality is related to positive employer and employee results and that perceived reciprocity of obligations may be dependent on the type of contract formed. Mutuality and reciprocity can be very influential on how family member and non-family members

perceive whether contracts are kept or broken. Contract breach may not occur as frequently when family members and non-family employees share similar beliefs about obligations that are owed to each other (mutuality) and how those obligations will be similarly returned to each other (reciprocity) as when less mutuality and reciprocity exists among each other.

Whether contract breach is perceived or not is critical to how psychological contracts affect organizational outcomes. Morrison and Robinson (1997) in their psychological violation development model identified perceived breach (the cognitive evaluation of contract non-fulfillment) as the immediate precursor to contract violation (the emotional/affective response to contract non-fulfillment). Their model also identifies possible moderators such as level of trust, fairness judgment, outcome assessment that may influence an individual's emotional or affective response to the perceived breach. Recently, another article found that personality characteristics moderated the perceived breach and violation relationship (Raja, Johns, & Ntalianis, 2004). Understanding how contract violation occurs and the possible effects on family firms' success and sustainability is critical since past psychological contract research has found violation related to decreased employee trust, organizational citizenship behavior, organizational commitment, and intentions to remain ENRfu (Robinson, 1995, 1996; Robinson & Morrison, 1995).

We believe evaluating psychological contracts in family firms is imperative due to the unique, permanent relationships among family members that extend beyond the business activities. These relationships may present the opportunity for the antecedents and outcomes of a psychological contract to be very different from non-family employees since the non-family employees may have clearer boundaries between work and family and may even terminate the entire relationship by leaving the business. Due to the unique, personal, and enduring relationships among family members, any psychological contract breach may be more severely felt than contract breach by a non-family employee. For example, a family member who exits the business would most likely experience greater psychological and other penalties than a non-family member who leaves the firm. Turnley and Feldman (1999) found that when managers perceived contract breach they were more likely to exit, to increase voice, to become less loyal, and/or engage in neglect behaviors unless certain situational factors were also present. If reemployment was likely, justification for the breach was insufficient, and procedural justice was low, then managers were more likely to leave the organization but not necessarily increase their voice and neglect behaviors or decrease their loyalty. Considering the exit, voice, loyalty, neglect framework for family firms, whether an individual is a family

member or not could moderate the breach—violation relationship and affect how the family member chooses to engage in exit, voice, neglect, and loyalty behaviors. While non-family members may not hesitate to leave the firm when the psychological contract has been breached, family members may not perceive exit as an available coping strategy. Rather, family members who perceive their contract to be breached but unable to leave the family firm may be more likely to perceive the contract has being violated which may lead to negative organizational outcomes. On the other hand, if non-family employees perceive that family members are treated more fairly then they may experience contract breach more often and engage in exit, voice, neglect, and loyalty behaviors to a greater degree leading to a greater detrimental impact on the family firm's performance. Additionally, what family members perceive they are owed and must similarly return to each other may be very different than the reciprocal obligations perceived by non-family members in the same family business. It is important to apply psychological contracts directly to the study of family firms, especially to the non-family members where concerns of fairness, trust, integrity and justice appear to be elevated and in light of the importance non-family employees are to family firm success. This will provide a more comprehensive approach to the issues because of the element reciprocity, where a mutual and cooperative relationship is examined between entities.

PROPOSITIONS

Appendix A provides a model of the role of psychological contracts in family firms. Following are propositions to support and help explain the model:

Proposition 1: Psychological contract formation within family firms will be different between family members and non-family members. Employment goals, information processing during the recruitment process, and an individual's personality can create different expectations for the non-family employee than the family member. We propose that family members will be more likely to form relational psychological contracts than non-family employees due to the unique, familial bond that family members have with the business.

- Proposition 2: Mutuality will moderate the positive relationship between the type of contract formed and contract breach perceptions such that the greater the alignment between the obligations that family members and non-family employees believe to be owed to each other, the less likely contract breach perceptions will be formed.
- Proposition 3: Reciprocity will moderate the positive relationship between the type of contract formed and contract breach perceptions such that the greater the amount of similar obligations returned by family members and non-family employees to each other, the less likely contract breach perceptions will be formed.
- Proposition 4: Trust will moderate the perceived breach and violation relationship such that non-family employees who have a high level of trust of family members will experience less violation than non-family employees who are less trusting of family members.
- Proposition 5: Personality characteristics will moderate the perceived breach and violation relationship such that family members and non-family employees who are equity sensitive or neurotic will experience greater violation than family members and non-family employees who are extraverted, conscientious, have an external locus of control, or high self-esteem.
- Proposition 6: Fairness judgments will moderate the perceived breach and violation relationship such that family members will experience less violation when procedural justice is perceived than when non-family employees perceive procedural justice.
- Proposition 7: Outcome assessment will moderate the perceived breach and violation relationship such that the greater the non-family employee's perceived discrepancy of outcomes between him or herself and the family members, the greater the likelihood that the non-family employee will experience violation than when the family member perceives an outcome discrepancy.

Proposition 8: Contract violation will be negatively related to family firms' sustainability and success measures such as tenure of business, profitability, size, employee turnover, organizational commitment, and job satisfaction.

CONCLUSIONS

The purpose of this paper is to provide a framework and theoretical model for examining the role of psychological contracts in family firms. Again, more than two-thirds of all organizations are family-owned and/or managed (Gersick, et. al, 1997) and the literature supports the fact that unique relationship and human resource issues emerge between and among family members and non-family members in family. These issues often focus on trust, fairness, integrity, and justice (Baldrige & Schulze, 1999; Blondel, et. al, 2000; Steier, 2001; Morris, et. al, 1996; Chrisman, et. al, 1998; Corbretta & Salvato, 2004; Schulze, et. al, 2003a; Schulze, et. al, 2003b; and Schulze, et. al, 2001). Applying psychological contracts to study the issues provides a more comprehensive approach because of reciprocity.

Of course, empirical research is imperative to test the model. This paper serves as a viable springboard for such studies, which can focus only on employees within family firms or draw comparative analyses between family firm and non-family firms. Several other factors should also be taken into consideration such as the size and age of the firm.

The overall goal is to increase effective management through human resource practices that enhance firm performance. We believe that understanding psychological contracts, how they are formed, how they are fulfilled, and their impact on employees is critical for family firm performance and sustainability.

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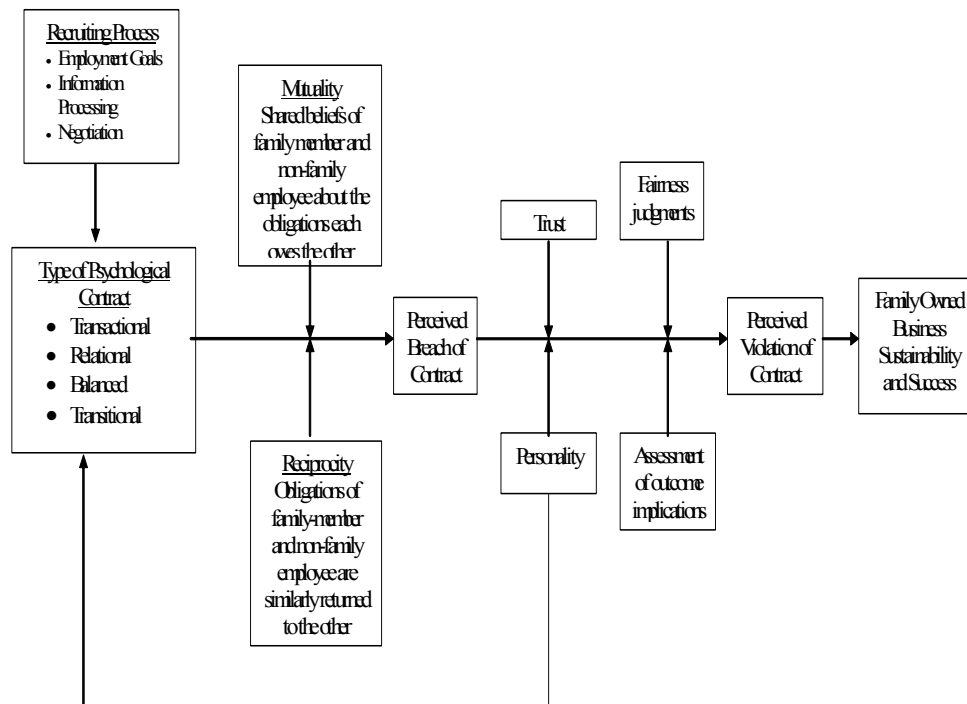
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APPENDIX A: MODEL OF THE ROLE OF PSYCHOLOGICAL CONTRACTS IN FAMILY-OWNED BUSINESS



GUERRILLA ACTIONS AS SMALL BUSINESS STRATEGY: OUT-WITTING IS MORE COMPETITIVELY RESPONSIVE THAN OUT-SPENDING

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ABSTRACT

Small and medium-sized firms face disadvantages in the dynamic global market place today. The authors suggest that “fast cycle decision making” – the application of Col. John Boyd’s OODA Loop philosophy can create economic advantages that will allow the smaller firm to aggressively compete against much larger rivals. Fast cycle decision making suggests deception, rapid response and being able to “turn inside” your opponent’s decision cycle. It is of interest to note that this version of guerilla warfare is now embodied in the United States Marine Corp’s new doctrine of Maneuver Warfare.

INTRODUCTION

Erich Fromm in his seminal work *Man for Himself* (1947) posited the following on the nature and character of man. He writes, “Reason, man’s blessing, is also his curse; it forces him to cope everlasting with the task of solving the insoluble. Man is the only animal that can be bored, that can be discontented, and that can feel evicted from paradise. Man is the only animal for whom his own existence is a problem which he has to solve and from which he cannot escape.” General Gordon Sullivan, former Army Chief of Staff, suggests in his book *Hope is Not a Method*, that “the essential character of strategy is that it relates ends to means” (Gordon and Harper, 1996). Finally, it is often reported that Sun Tzu in the *Art of War* claimed that “all strategy is based on deception, with the expert

approaching his objective indirectly.” The authors of this manuscript propose that in business there exists a basic dilemma of gaining economic victory in the shortest possible time; incurring the lowest possible costs; while suffering the fewest delays and set-backs. Accordingly, the nature of business produces a requirement for a planning mechanism that drives decisions, creates spontaneous innovation, and produces administrative comfort within the methodical processes generally associated with business strategy. This is particularly true for small and medium-sized enterprises (SMEs). Those firms have, characteristically, severe resource constraints as compared to their large competitors and so their strategies and related tactics have to be *quick, disruptive where possible*, and more than anything else *correct*. Frequently there is no margin for error.

As considered in this manuscript, the rapid transformation of the market place from an oligopolistic domestic to the highly competitive monopolistic global has brought about an emergent use and study of guerrilla tactics. It is suggested by the authors that guerrilla actions that can increase entrepreneurial opportunism and result in the inability dominant “behemoth” institutions to SMEs when resolving market-based problems. It is reasonable to assert that the effective use and understanding of these varied and unconventional techniques gain greater and more comprehensive discussion in the decision making of SMEs with the inclusion of a specific, rapid response decision model. The purpose of this article is to initiate the creation of general theories of an otherwise random set of actions, conveniently referred to as guerrilla—a term that in many circles conjures images of disreputable bandit maneuvers that destroy order and impede objective-driven performance.

Guerrillas are decision makers. The desired economic result of this decision making is market disequilibrium and a reduction of the dominance of larger, more resourced organizations. Guerrilla activities are also effective opportunities to introduce innovation, provide economic prosperity, and create jobs. Guerrilla activities are inherently entrepreneurial in nature. Schultz (1980, pp. 439) described entrepreneurial decision-making activity as creating “disequilibria that are inevitable in the dynamics of modernization and economic growth.” It is the disequilibria of the guerrilla that has the potential to produce greater value, more robust innovation, and that enhances the return on investments by SMEs. This paper suggests that there exists with guerrilla tactics a specific decision-making process that is very much in concert with entrepreneurial excitement. In general, guerrilla tactics are proactive decisions that are asynchronous, rapidly developing measures that are taken to both survive and thrive in highly competitive and economically hazardous conditions.

BRIEF HISTORY OF GUERRILLA WARFARE

The term “Guerilla” means *small war*, the diminutive of the Spanish word *guerra* (war). The use of the diminutive suggests significant differences in number, tactics and scope between the guerrilla army and the formal army it opposed. The word was coined in Spanish to describe the nature of their opposition to Napoleon’s regime and came to be used to describe any similar type of conflict. Clearly, guerilla warfare preceded Napoleon by centuries. The Fabian strategy applied by the Roman Republic against Hannibal in the Second Punic War was an example of guerrilla warfare. Likewise, Hungarian peasants facing the Mongols after the Battle of Mohi used guerilla tactics as did the 19th century Balkan population in conflict with the Ottoman Empire.

In later years, Mao’s conquest of China, the relative success of the IRA against British forces and Ho Chi Minh’s early battles in the Vietnam War are all examples of success of small, highly mobile forces with good intelligence against much larger conventional forces. It is of interest to note that the United States Marine Corps has developed a relatively new doctrine – Maneuver Warfare – that reflects the basics of guerilla warfare and also is based on the work of Col. John Boyd in his twenty years of consulting experience at the Pentagon (Richards, 2004, Santamaria, Martino & Clemons, 2004).

GUERRILLA STRATEGY CONGRUENCE

Strategy formulation is largely an intellectual activity; the analysis of abstract relationships; the development of plans intended to produce predictable and desirable outcomes; the manipulation of mechanical processes, inventories, and logistics, within organizational competencies and culture; constrained by the scarce resources of the firm. It is reasonable to assert that entrepreneurial firms (SMEs) have fewer and more vulnerable resources than institutions or large multi-national conglomerates. Dettmer (2003) details a constraint management model definition of strategy development as “the means and methods required, satisfying the conditions necessary to achieving a system’s ultimate goal.” Within this context, the author(s), in alignment with Dettmer (2003), suggest that guerrilla or entrepreneurial decision making focuses resources on objectives quickly, effectively, and efficiently, with goal orientation being more long-term than near-term guerrilla. By extension, large institutional decision making and strategy development fail in one or more of these basic characteristics. Academically, business strategy and

decision formulation has largely followed an inverted hierarchical process model that is relatively inflexible and certainly long-term. However, the 21st century, globalized business environment is more complex and demands rapid change, and flexible, asymmetric decision making.

The authors suggest that decision making at the SME level is by its very nature a rapid, iterative, interactive responsibility process involving people and their dependent, independent, and interdependent relationships to the various environments (internal and external) that tend to shape, reshape, and disrupt the various elements of doctrinal strategy and policy on a painfully persistent basis. Further, because of the entrepreneurial nature of SMEs, decision making is the creation or recreation of the fundamental set of relationships characterizing an entrepreneur's or founding team's behavior: its environmental, internal and input-output parameters that often are in conflict with contemporary theories of strategic business. Accordingly, the entrepreneur, ergo nascent guerrilla, must balance the many elements of the total organization within the reality of survival and value-centered integrity and must implement decisions within time and resource constraints that can have devastating consequences if left unattended or slowly attended.

In 1991, Jerry Wind, the Lauder Professor at the prestigious Wharton School, and Alfred P. West, Jr., the Chairman and Chief Executive Officer of SEI Corporation, reported in the October issue of *Chief Executive* that the 21st century enterprise would be organized and managed in dramatically different ways from the firm of the 20th century. They suggested that the new paradigm would be the result of remarkable changes in the emerging global economy. Changes in the global business environment have, in retrospect, created new challenges for enterprise and decision makers alike. This fundamental shift in perspective at the global level requires different models of the decision-making process, because the consequences are dramatically more rapid and significantly more impactful. Further, all organizations will be required to adopt flatter structures, greater empowerment, and substantially more high-speed, reduced-cycle decisions at all levels. Guerrilla techniques, when examined, may provide a platform for extension and expansion of rapid, asynchronous, decision-making models.

Layered decision-making models (strategic planning models) do not provide speed, flexibility, and responsiveness needed to move more efficiently and effectively in the global environments faced by the SME. While it is important to begin with a mission orientation and move culturally through the executive strata into the root structure of the varied function of the organization, it is more critical

to recognize opportunity and exploit the opportunity quickly and robustly, realizing that consequences of such actions may endanger the organization. Regardless, Sullivan and Harper (1996) emphasize that “real change takes real change.” Changing critical processes is not simply making adjustments at the margin.

THE PRINCIPLES OF GUERRILLA ACTIONS

At the most basic, guerrilla activities are the practical methods of achieving objectives that differ little from the more conventional strategic objectives. Guerrilla decisions should, in an analytical sense, compliment doctrinal strategy. Fundamentally, guerrilla decisions and activities provide greater flexibility, variability, and adjustability during the entrepreneurial struggle of most (if not all) SME existence. The long-term objectives remain constant in the long-run: (1) profitability for growth and development; (2) marketability for the purpose of creating and maintaining customer satisfaction (Levitt, 1965); and (3) organizational stability for cultural harmony and health. Still, there are few, yet basic, principles that should be introduced so that all activities are not attributed to guerrilla for the sake of dismissive expedience.

The first set of principles considered provides the framework of contemporary SME and is not intended to support any specific type of guerrilla decision. Too often guerrilla tactics in business are seen as being specifically designed to dismantle and not merely disrupt. The author(s) suggest that while there is a disequilibrium that may occur in the wake of guerrilla decisions, the intent is to formulate a more rapid decision-making and competitive response process. The principles posited are adapted from those promoted by Ernesto “Che” Guevara, the Argentine- born revolutionary, in his treatise on guerrilla warfare in 1961. They are:

- Principle 1: Popularly demanded products and services can extract considerable market responsiveness when confronted by larger corporate product and service offerings.
- Principle 2: It is not necessary to wait for all conditions to be strategically aligned to implement guerrilla activity decisions.
- Principle 3: The local/community market-place is the best and most basic area for guerrilla activity success.

Of these three basic principles, the first directly contradicts the general business wisdom embedded in Porter's Five-Factor Model of Market profitability (1980), which suggests that the number of competitors, their size, and their commitment of resources will determine the intensity of competition. While it is imperative that the issues of viability remain foremost, the guerrilla can survive and thrive in a more structured strategic environment of larger, more dominant organizations without spending inordinate resources concentrating on the combined effect of these profitability variables. This contradiction does not negate the strategic importance of the five factors; rather the contradiction provides the impetus for action at a level that does not depend upon size or power of the participant.

The second principle provides the platform for action. While economists and strategic theorists promote the benefit of strategic alignment, the guerrilla very often possesses neither the resource capability nor the competitive position to wait. Herein it is important to assert that guerrilla activities are actions of precision and not actions of dominance. For the SME, time is critical, and decisions must be made without perfect information or strategic resources.

Together these first two basic principles provide the morale boost to empower and enable SMEs to engage selectively and decisively. Guerrilla activities help the SME decision making to crystallize more effectively around specific target markets, specific objectives, and with specific metrics of success, significantly more so than the slower, vaguer and often abstract aspects of corporate, strategic decision making.

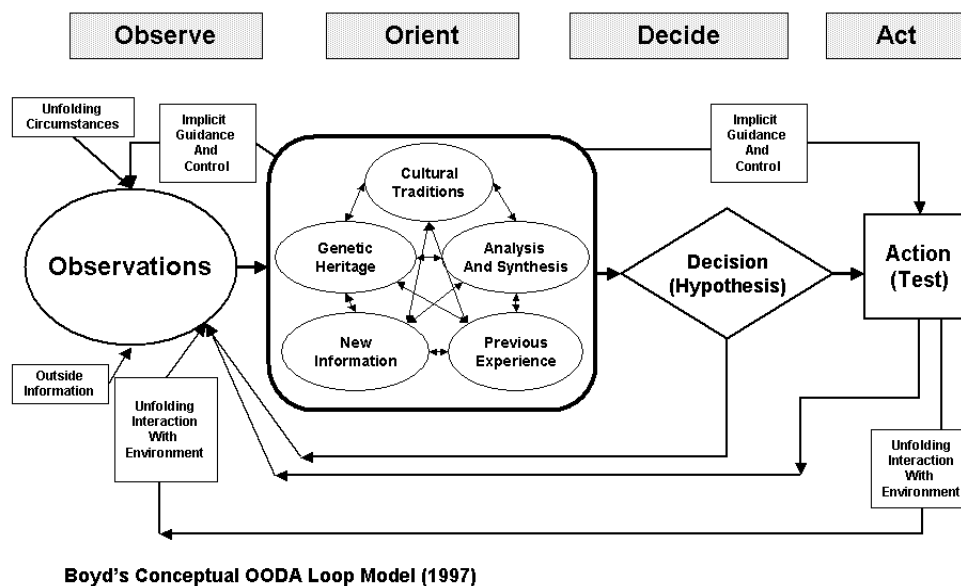
Additionally, the third principle is fundamentally a proposition of location of action. Too often, larger, more global organizations will dogmatically opt for the large, aggregated population characteristics and forget or neglect the immense power associated with smaller, more localized communities. Actions that focus on the creation of stronger local participation can grow more predictably with greater tensile strength. This requires the SME to use patience and discipline in lieu of vast sums of otherwise scarce resources. It also requires the SME to focus its product or service attributes and benefits to a precisely defined set of demand characteristics. Moving responsively does not imply moving precipitously.

THE OODA LOOP AS A GUERRILLA DECISION MODEL

OODA is an acronym for Observation, Orientation, Decision, and Action. This sequence of individual and/or organizational cognitive processes is also referred to as the "Boyd Cycle" because it is attributed to the late Colonel John R.

Boyd, a pioneering jet-fighter pilot and strategic theorist with the U.S. Air Force. It was Colonel Boyd's practiced belief that combat-fighter aircraft operate and successfully achieve specific mission-essential outcomes in an ultra-dynamic, continuously evolving set of environments, and that critical to the success of the individual pilot and the entire organization was the ability of the pilot to make accurate, appropriate, and strategically responsive decisions (Boyd, 1997). The author(s) suggest that the OODA Loop model fits highly dynamic, competitive decision methods wherein the "decision maker intuitively maps operational flows, seeks ways of reducing critical path implementation time of competitive activity, and closely monitors progress" (Dickson, 1992). Entrepreneurs and guerrillas, like successful fighter pilots, enter new competitive encounters employing the mind-time-space relationship of variety, rapidity, harmony, and initiative to attain a specific objective (Spitaletta, 2003). Refer to Figure 1.

FIGURE 1



Decomposition of the OODA Loop procedure within general theories of entrepreneurship and the three principles of guerrilla decision activities that are articulated herein may provide valuable insight into the decision-making specifications and benefits associated with SMEs, entrepreneurial enterprise, and

guerrilla strategy. This understanding may also assist curriculum developers in the rapidly emerging field of entrepreneurship and guerrilla marketing education. While Boyd did not intentionally focus on speed of decision making in highly dynamic, high-risk environments, he posited that with training, combat pilots could gain “a competitive advantage from quickness over the entire loop” (Boyd, 1997). The OODA Loop is an interactive (decision maker with environment), non-sequential process that provides remarkable stability in making critical decisions in environments that are constantly changing, modifying, and morphing in largely unpredictable ways. Boyd developed the OODA Loop concept, which is similar to the global business environment in that it underscores the need for combined rapidity, initiative, harmony, experience, culture, tradition, and variety or what he termed the “time, mind, and space” concept of decision making in action. In highly competitive environments where the consequences are literally survival, Boyd believed that an adaptive, individually responsive decision process would provide greater success and accomplish complex missions more predictably. Boyd’s OODA Loop was formulated to be consistent with the centuries-old strategy philosophy of Sun Tse updated for the 21st century, “Work to defeat the enemy’s plan, rather than the enemy’s forces” (Griffith, 1963).

When considering the appropriateness of the OODA Loop process within the guerrilla entrepreneur’s decision making, one must recognize that Boyd believed that “the business of life is life itself, which cannot be accomplished without survival and is more effective if prosperous” (Spitaletta, 2003). Accordingly, the first and most important priority is the survival of the SME, followed closely by the ability of the firm to independently sustain and prosper. In a practical sense, for the process to be operational, the critical elements of the OODA Loop must first undergo scrutiny to assess the viability within business contexts. From Boyd’s theory of maneuver warfare, entrepreneurial enterprise can adopt the concepts of shaping the environment, adapting to the changing form of competition, coping with uncertainty, using time as an ally, and degrading the competitor’s ability to cope (Hammond, 2001).

Observe: The observe component is the 360-degree lens wherein real-time data enters the sensory awareness of the decision maker. These raw, untransformed bits are ubiquitous, without specific form, and do not, at this early stage, provide any substantive decision-specific information. The usability of these various phenomena is at best speculative. These data enter the decision maker’s cognitive sensors as a set of otherwise unpredictable and therefore uncontrollable circumstances and unrecognized, externally generated, “stuff.” These are rapid, various, successive,

foreign, and potentially threatening to the survival if left unrecognized, unattended, and unresolved. This “rush” of data stresses the ability to make critical decisions unless the decision maker possesses a well-trained or highly intuitive guidance ability to maintain for-the-moment, and a process that can be exploited to create productive survival in the face of otherwise threatening events. This requires a well-formed observation ability that integrates and catalogs incoming data at a rapid yet manageable rate, preparing the data for information processing in a coherent prioritized manner. These data include (1) outside information, (2) unfolding circumstances, (3) unfolding interactions with the environment, and (4) components of an implicit guidance control.

Orientation: Perhaps the most critical of the model components is “Orientation.” While observation provides the data, it is orientation that shapes and filters the data into usable decision-sensitive information. This shaping function provides context, urgency or currency, and dimensionality to the phenomena. The entrepreneur’s ability to perform this filtering and prioritization activity flows from the set of interdependent attributes that may be available at any given moment. When faced with a decision situation, the combined effects of genetics, culture, tradition, heritage, expertise, experience, analytical skills, and synthesis engage to formulate a “plan of action.” While intuitively obvious that during the heat of battle, it is nonetheless requisite for the entrepreneur to engage this process quickly or risk a loss of innovative leadership.

Decide: Feeding forward from the orientation component, the decision maker must determine possible courses of action, evaluate possible consequences, make critical selections, and decide. Entrepreneurial decision making can be enhanced through experience, training, schooling, and innate ability (Schultz, 1980). Accordingly, decision heuristics are the result of the orientation associated with the individual or organizational elements responsible for making decisions: implicit and explicit.

Implicit decisions emerge as the workings of the unconscious mind, leading to actions based on feelings and tacit knowledge running under a form of automation, guided by hidden beliefs, internalized values, or perhaps strongly established habits. Some are explicit, and others are implicit. Explicit business decisions are more classical to the strategy formulation process. These include decisions regarding investment in a production plant, increase in personnel, price changes, product positioning, etc. In formal strategic planning and decision models, explicit decisions gain access to available process resources, meaning management time, process/approval framework, analytical support, risk assessment, cost/benefit

calculation, sensitivity deliberations, etc. This OODA loop model serves the implicit decision with similar methodological purpose because it relies on the innate as well as the formal: explicit decisions tend to be influenced more by orientation and reorientation process, and implicit decisions tend to rely on culture, heritage, and experience. Regardless, decisions made require action to be taken.

Act: Entrepreneurial/guerrilla enterprise decides to pursue or not pursue a course of action based on the incentives or consequences that are perceived as associated with the investment of skills and resources (Rosen, 1983). Actions that are predicated primarily on harvesting incentives provide opportunity, while actions that are tied to avoiding adverse consequences are generally considered to be defensive. Actions taken are on one hand the end of one loop and on the other hand the beginning of another related loop because the effect of the actions taken produces outcomes, predictable and unpredictable, that produce new observations and require different orientations, which require new or adjusted decisions, which again require action. The OODA loop closes and reopens simultaneously. This opening and simultaneous closing tends, over time, to make the OODA loop resemble more a spiral that draws closer with each sequential pass. This tightening reduces decision cycle time, improves the predictability of successive decisions, and provides the organization with the ability to drive down the decision making to the most beneficial level.

DISCUSSION

Many strategy experts advocate that the strategic decision-making process should be deliberate and methodical (Andrews, 1971). This suggests that strategic business decision making in the 21st century can continue to depend on management models that appear to ignore the reality idea that strategy must emerge from situations, such as the 3M Corporation's Post-It notes. In this regard, Mintzberg (1994) suggests that there is a distinct difference between strategy formation and strategic planning, just as there is in the heat of battle a distinct difference between tactical engagement and doctrine. SME guerrilla activities in a highly dynamic and competitive global setting require decision-making models that allow strategy to emerge spontaneously at least as often as it is deliberately planned.

The model herein described to accommodate both the spontaneous and the preplanned is the OODA loop or Boyd Cycle. This four-step process, repeated and repeated, provides the decision maker with the ability to make more specific decisions, in a more rapid period of time. While Boyd did not specifically set out

to reduce cycle time, he quickly acknowledged that the process provided the framework for such reductions. Additionally, an integrated use of this process provides the decision maker (entrepreneur or fighter pilot) with the highly desirable ability to get “inside” the competition’s OODA Loop. This counteractive ability is especially useful when business specifically targets a competitor, as illustrated when a local, independent retailer or producer identifies and then encourages coupon redemption (regardless of source), or when Voices for Choices targeted SBC (now AT&T) as a greedy and unethical corporation (Bocij, 2002).

OODA loops can describe how an SME guerrilla decision deploys rapidly developing asymmetric strategy and then by the iterative process inherent in the loop or cycle can adjust the strategy to meet the changing conditions surrounding the initial decision. Further, when needs arise, the OODA loop can be circumvented by performing the orientation and decision steps first. This would provide the flexible SME with the ability to predetermine courses of action when circumstances are observed. These types of tight cycles are found today in automated stock trading programs (Nichols et al, 2000). The results are potentially devastating to the traditional financial planning company and just as potentially rewarding to the guerrilla trader, such as Scott Trade.

This paper has posited three basic principles of guerrilla strategy, and it has introduced the OODA loop concept into the entrepreneurial decision-making discussion for SME strategy. As globalization and world politics continue to expand opportunities, there will also be an expansion of the competitive pressures that require more agile strategy development and more efficient, effective, and accountable decision making. The smaller enterprise that is able to shrink the decision cycle can expand opportunities while reducing threats to survival and growth. When trained and implemented, today’s guerrilla-shaped entrepreneur, just as today’s jet fighter pilot, will gain competitive superiority faster.

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HOLES IN THE CORPORATE VEIL: CONFRONTING THE MYTH OF REDUCED LIABILITY FOR SMALL BUSINESSES AND ENTREPRENEURS UNDER CORPORATE FORMS

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ABSTRACT

Entrepreneurship textbooks are devoid of some of the more complex legal analysis that would lead would-be business founders to a more informed understanding of the limitations of corporate forms in affording protection from personal liability. Indeed, these texts may have contributed to what amounts to a myth in causing entrepreneurs to believe that they are personally separate and invulnerable, so long as they have taken the step to incorporate, as compared to operating as an individual under a sole proprietorship. The authors of this paper have quoted the term "myth," because practicing corporate attorneys and the plaintiffs they represent, the courts, and legal scholars are keenly aware of ongoing efforts to devise strategies and methods to pierce the corporate veil; of course, defendants also do become aware of their vulnerabilities (but perhaps too late).

Despite such a legal landscape, our review of contemporary entrepreneurship textbooks and the scholarly literature of entrepreneurship undergirding these texts demonstrated a failure to convey that increasingly, there are holes in the corporate veil. This paper provides an overview of issues that merit consideration on the topic of the corporate veil and veil piercing, and concludes with a discussion of implications for entrepreneurship teaching, research, and practice.

INTRODUCTION

"An important consideration in starting a business is whether to form it as a corporation. Organizing a business as a corporation offers many advantages. For example, the ability to sell stock can be a significant help when raising capital" (Peckinpough, 2000). "When presented with any kind of potentially devastating liability, an attorney's instinctive response is to create a separate corporation to 'shield' the rest of the corporate family, and the individual assets of those who direct it" (Jackson, 2001). The basis for this present paper is dispelling the "myth" (Graham, 2002) of the corporate veil, the affects of which are the mistaken opinion that entity formation makes individuals bullet proof for all but acts of fraud (Lowenstein, 1989; Prieston, 1999; Russell, 2004; Shub, 2006; Wagoner, 1996) and intentional acts of gross negligence (Bendremer, 2005; Hughes, 2004; Rolle, 2003).

The authors of this paper believe that this myth is due to a paucity of coverage in entrepreneurship textbooks, and because a lack of attention has been given to veil piercing in the scholarly literature of entrepreneurship, which at least insofar as this topic is concerned seems to exist in a relative vacuum, separate from legal scholarship. This statement should not be interpreted as a criticism. Rather, we recognize that entrepreneurship is a relatively new and emergent scholarly discipline. Further, we think it is quite reasonable to posit that perhaps other factors are in play, such as the widely disseminated explanations regarding the benefits of forming a corporation that appear in generalized business books, on web sites, and in articles disseminated through the popular press and trade publications (sans any adequate explanation to the effect that "there is always a catch" - one must abide by certain rules and conditions in order to pass the legal test of veil piercing).

"Most savvy business people are aware that corporations offer some protection to officers, directors and shareholders from personal liability. What many people may not know is that the corporate shield from personal liability is not infallible" (Hughes, 2004). As suggested by practicing attorney Stanford A. Graham, Esquire, "the majority of veil piercing activity never makes it to the courtroom. Rather, when business owners are threatened with litigation, and become aware of their vulnerability to veil piercing, they pay expensive settlements to avoid litigation" (Graham, 2002). Indeed, "situations are often compromised because they are so expensive to litigate" (Hays, 1998). Settlements under a threat of suits that may involve veil piercing are also possible, and in these instances, reporting may be obscured (Guglielmo, 1996).

Generally, piercing is a remedy to hold individuals accountable for abuses of the corporate form, including hiding behind a corporate entity in order to defraud creditors, investors or other claimants (Bainbridge, 2001; Caudill, 2003; Mirchandani, 1998; Russell, 2004; Wagoner, 1996).

"The [veil piercing] doctrine most often arises in connection with plaintiffs' attempts to hold corporate shareholders liable for the debts of the corporation" (Bendremer, 2005). As case law indicates, being undercapitalized (and knowing so) is not reason to hide behind the corporate veil when one defaults on a contract or other obligation (Peckinpugh, 2000). In instances such as these, the remedy (on the part of a plaintiff) of veil piercing is apparent because the business was undercapitalized to carry out the terms of the agreement from the start.

However, veil piercing can become even more tumultuous, and "the risk is much greater than most people realize" (Graham, 2002). The corporate veil will not protect a business when acts or omissions will result in unfairness to the injured party: "The determination of whether the doctrine applies centers on whether there is an element of injustice..., fundamental unfairness, or inequity" ("State ex rel. Christensen v. Nugget Coal Co.," (1944). Unfairness!!! To this we exclaim "holy cow," as the inclusion of this descriptive term in the court's finding is very far reaching, as most *any* plaintiff can assert unfairness.

For the reasons suggested above, we were compelled to offer this first paper as a contribution to the scholarly literature of small business and entrepreneurship (hereinafter our references to the scholarly literature of small business and entrepreneurship will be expressed simply as, "entrepreneurship" for purposes of brevity and expediency).

REVIEW OF EXISTING LITERATURE ON "PIERCING THE CORPORATE VEIL" WITHIN THE SCHOLARLY LITERATURE OF ENTREPRENEURSHIP

Vanderbilt University Professor of Law Robert Thompson (Robert B. Thompson, 1995) is regarded to have provided an "exceptional study" of veil piercing (Morrissey, 2007; Rapp, 2006). "Veil piercing issues can also arise with regard to limited partnerships ('LPs') and limited liability partnerships ('LLPs'). Like LLCs, LPs and LLPs are unincorporated business entities" (Bendremer, 2005). However, the need for this present paper became evident after a series of searches

in the scholarly entrepreneurship literature revealed a dearth of research on the subject of the corporate veil and veil piercing. Search attempts conducted on databases used by *ProQuest* demonstrated that veil piercing was only covered within the literature from within scholarly and professional legal and accountancy contexts, typically associated with legal, finance or accounting oriented journals.

With parameters for our searches set to identify only articles with full-text availability and results in the citation and abstract, we identified 155 articles in *ProQuest* databases originating from sources that were not associated with the scholarly entrepreneurship literature. Upon attempting to combine the term "corporate veil" with others such as "corporate veil" AND "entrepreneurship" we found only one result (from an Australian journal published in 1992).

The popular business press produced some results in our *ProQuest* searches (but upon examination, some of these were erroneous and associated with other topics). Finally, we also examined several leading entrepreneurship textbooks and found that forms themselves were typically well covered, but emphasis on possible pitfalls and vulnerabilities was not as well developed as probably should be (Hisrich, Peters, & Shepherd, 2008; Kuratko & Hodgetts, 2007; Price, 2005; Roberts, Stevenson, Sahlman, Marshall, & Hamermesh, 1998; Wickham, 2006; Zimmerer, Scarborough, & Wilson, 2008). We presume that the paucity of results in the entrepreneurship scholarly literature may partially or largely explain the scant coverage of issues and consequences associated with veil piercing in contemporary entrepreneurship texts. Many misconceptions (Mauldin & Wilder, 1997) appear to exist.

Besides the general lack of coverage in entrepreneurship texts and the scholarly entrepreneurship literature which undergirds those texts, veil piercing is an evolutionary (Bendremer, 2005) topic within the legal community. It has also "been one of the most hotly debated concepts in business law" (Rapp, 2006), with "a long, if controversial, history in the law of business" (Morrissey, 2007). However, both the would-be and established entrepreneur may typically fall under the false impression that the corporate form provides a bullet-proof shield (Graham, 2002) of protection against personal liability claims. "Statutes created the legal fiction of the corporation being a completely separate entity which could act independently from individual persons" (Eisenberg, 2005). Beyond liability issues, other circumstances such as tax consequences dictate that one should "frequently consider and reconsider the entity options" that may be available (Massingill & Mares, 2007).

AN ABBREVIATED HISTORY OF THE CORPORATE FORM

The history of corporations is well covered elsewhere (Clemens, 1998; Morrissey, 2007; O'Kelley, 2006; Wells, 2007), and it is not our purpose to retell that history in this present paper. However, a brief review should serve to provide context for entrepreneurship scholars who have not arrived here through education or practice with specializations in management or corporate law. As outlined by Morrissey (Morrissey, 2007):

The earliest corporations in British legal history were ecclesiastical and other privileged organizations chartered by the sovereign and allowed perpetual existence beyond the life-time of their individual members.³⁰ In the new American Republic, incorporation continued to require individual acts by legislatures,³¹ which were most often granted for special projects such as creating canals, banks³² or roads. As the industrial revolution began in earnest in the U.S. around 1825, businesses began to need capital from widespread investors. At that time, corporate statutes first started providing limited liability for shareholders³³ and state legislatures created general laws allowing businesses to incorporate by merely filing certain documents with designated government officials.³⁴ Parliament passed the first Limited Liability Act in 1855³⁵ and by then limited liability had also become a standard feature in the corporate codes of American States.³⁶

In the United States, the State of Wyoming passed the first LLC statute (in 1977), "but it was not until 1988 that LLCs received considerable attention following an IRS ruling clarifying that they could be taxed like partnerships in spite of their limited liability status" (Rapp, 2006). Indeed, "corporate law's most dramatic revolution of the last quarter-century has been the emergence of the Limited Liability Company (LLC) as the dominant business form for small businesses" (Rapp, 2006). "Limited liability has always been one of the major attractions of a business form for those engaged in a closely held business" (Robert B. Thompson, 1997).

In terms of the present state of affairs in the corporate and legal arena (and again, with no apparent acknowledgement in entrepreneurship textbooks or

scholarly literature), "veil piercing is the most litigated area of American corporate law" (Rapp, 2006).

METHODS BY WHICH VEIL PIERCING MAY OCCUR

"Veil rules share a family resemblance with rules that forbid conflicts of interest [i.e., "self-interested decision making," also used here as an explanatory comment from elsewhere within Vermeule]" (Vermeule, 2001). "The doctrine of veil piercing has its origins in corporate jurisprudence and usually arises in the corporate context" (Bendremer, 2005). "The doctrine holds that in order to encourage investment, and to protect investors from losing more than their initial investment, no liability should be imposed upon shareholders beyond the corporate assets" (Rolle, 2003). However, as is the case for many rules, exceptions typically follow.

The applied test for corporate veil-piercing is *Van Dorn Co. v. Future Chemical and Oil Corp.*, 753 F.2d 565 (7th Cir.1985). ("*Van Dorn Co. v. Future Chemical and Oil Co.*," 1985). A corporate entity will be disregarded and the veil of limited liability pierced when two requirements are met: "(F)irst, there must be such unity of interest and ownership that the separate personalities of the corporation and the individual (or other corporation) no longer exist; and second, circumstances must be such that adherence to the fiction of separate corporate existence would sanction a fraud or promote injustice." "Corporate veil piercing most often applies in cases of (i) fraud; (ii) inadequate capitalization; (iii) failure to adhere to corporate formalities; and (iv) abuse of the corporate entity that results in complete dominance by the shareholder or shareholders" (Bendremer, 2005).

"Normally when the [veil piercing] doctrine is used, it is used to punish corporate directors for financial misconduct, but in the wake of Enron and similar scandals, 'there's a general siege on the walls of corporate immunity'" (Anonymous, 2006). Although certainly not the first (and we presume not the last) corporate scandal to occur, the Enron case has been exposed as a tragedy affecting employees, shareholders and others, such as the Arthur Andersen accounting firm partners who became embroiled in the controversy surrounding its demise (Pacelle & Dugan, 2002). In the latter instance, this occurred when "Enron creditors, shareholders and employees...[sought] to recover the billions of dollars they have lost from someone" (Pacelle & Dugan, 2002).

Among its other transgressions, "energy giant Enron Corp...gave gifts to non-profits associated with Enron board members" (Klein, 2005). The issues were

indeed systemic, as a culture of corruption arose (Emshwiller & Smith, 2001). As suggested in a *Knight Ridder Tribune Business News* editorial, ("Editorial: The corporate veil," 2006):

American business leaders cannot have it both ways. They cannot allege on the one hand that a corporation is like an individual with all the rights of free speech and privacy accorded to individuals and on the other hand attempt to conceal wrong-doing by disclaiming knowledge, like the piano player in a house of ill-repute who denies knowing anything about what's going on upstairs. In the Enron trial, which began this week, Enron big-wigs Kenneth Lay, company founder, and former CEO Jeffrey Skilling are expected to defend themselves against felony charges with the classical "barefoot boy on Wall Street" defense that "how wuz they supposed to know" about all the cooking of corporate books and other skullduggery that eventually brought the company to ruin.

"Exposure of Enron's frauds triggered a national debate on the need for corporate reform" (Jones, 2004).

Of course, Enron was not the only scandal to shake investors' confidence in capital markets. As allegations of fraud were brought forward against other giants such as Worldcom, "Wall Street was harboring a dirty little secret. Some of its highest paid investment bankers were handing out hot IPO3 shares in return for kickbacks. Others were offering favorable stock recommendations from their research analysts [who suffered from numerous conflicts of interest]" (Scianni, 2003). Collectively, these scandals led to the Sarbanes-Oxley Act, which was signed into law by President Bush in July 2002 (Scianni, 2003).

Notwithstanding the above high profile instances of fraud and scandalous behavior, smaller firms are more likely to make mistakes or otherwise commit acts that lead to the use of the veil piercing remedy on the part of plaintiffs (a discussion regarding prevention is provided in a subsequent section of this paper). In some instances, incorporations may occur in an effort to avoid preexisting personal liability issues. For example, in a Norfolk Virginia case, the court determined that two roofing contractors engaged in an effort to evade personal liability by hiding behind a corporate shield (rather than simply addressing problems by replacing or repairing defects in the roof they constructed for a condominium complex): "the

evidence supports the conclusion that they simply determined to form...[a corporation] and, ultimately, to use that corporation to evade personal liability while the condominium continued to be marketed with a known defective roof" (S. Williams, 2003).

As was determined through a case decided by the Saint Louis County trial court, the defendant, an orthopedic surgeon, "went to great lengths to divert his earnings from his debtor into various corporations" (Umbright, 2004). Among other things (e.g., shifting monies to various trusts and corporations), he "had not received any wages for his medical services...because those wages were transferred to his wife" (Umbright, 2004). Basically, "to pierce the corporate veil of limited liability protecting a company and establish a cause of action against its directors in their personal capacity, there needs to be an assumption of responsibility" (Mirchandani, 1998).

PREVENTING VEIL PIERCING

"Using a corporate form ordinarily will insulate the owners from direct liability for the company's obligations, because the corporation is considered to be a separate legal identity, independent of its owners" (Peckinpugh, 2000). However, and this is a significant "however" often omitted in form or substantive discussions within textbooks, the scholarly literature of entrepreneurship, and in popular press outlets: this shield can only be effective if certain conditions are met. These conditions vary somewhat from state to state, and courts have interpreted cases based on what typically entails extensive examination of whether or not veil piercing is a justifiable remedy. In other words, "although using a corporate form for doing business can provide many advantages, investors who use this approach must be careful to follow the rules to maintain those advantages" (Peckinpugh, 2000).

Certain common principles tend to apply to the concept of veil piercing, regardless of venue (i.e., place where cases are decided). For example, "one of the oldest ways to 'pierce the corporate veil' is to show that a corporation was created for an illegal purpose" (Jackson, 2001). Thus, as simplistic as it may sound (upon knowing one of the most common sources of vulnerability), to prevent veil piercing, corporations and individuals within them (or with whom they have dealings), generally, should be careful not to commit any illegal acts. As another example (fraud), "receiving 'insider' and other payments" (Turcotte, 2005) prior to filing for bankruptcy protection would expose a corporation to a veil piercing test. "Tort law

in the United States has the same common law foundations as tort law in most other nations" (Rolle, 2003) and fraudulent behavior or negligence associated with illegal acts is certainly suggestive of both litigation as well as what would likely become a successful petition for relief through the veil piercing doctrine.

Hence, one should also "avoid committing any torts. Examples of tort claims are negligence and fraud, in contrast to contracts" (Hughes, 2004). "In a tort case, liability links the defendant to the plaintiff's injury" (Rolle, 2003). "Tort law provides a structure to understand the separate 'wrongfulness' of fraud, but in a way that also could suggest limits on recovery. By recognizing lying as a wrong, law recognizes this conduct as an inappropriate way of treating people that gives rise to an individual right of redress" (R. B. Thompson, Spring 2006). "Tort law encompasses several different categories of civil wrongs, which can empower a judge or jury to impose monetary damages on a tortfeasor if he is found to be liable for the given damages" (Rolle, 2003). For example, "toxic tort law includes a smaller category of civil wrongs, in which there has been some harm 'to persons, to property, or to the environment'" (Rolle, 2003).

"The right to a law of redress has deep roots in Anglo-American law" (Goldberg, 2005). According to Rolle (2003):

Many corporations are grateful for the protections they are granted and try to set their subsidiaries up so as to avoid liability in the event that any tort allegations arise based on their subsidiaries' activities. The general rule in the United States is that the parent will not be held responsible for the actions of its subsidiary unless there is some evidence that the parent has perpetrated some fraud.³⁰¹ This kind of fraud is not frequently shown, but where "stock ownership has been resorted to ... for the purpose ... of controlling a subsidiary company so that it may be used as a mere agency or instrument of the owing company or companies," then the veil may also be pierced.³⁰² When a court finds that this kind of fraud has been committed, it then may "pierce the corporate veil" and reach the assets of the parent.³⁰³ In rare cases, a parent corporation may also be held liable, and lose the protection of the corporate veil, if the plaintiff can show that the parent was directly involved in the day-to-day activities of the subsidiary corporation.³⁰⁴ This is not technically considered piercing the veil, as the parent becomes directly liable for its own actions in these

*cases, rather than derivatively liable for the actions of its subsidiary.*³⁰⁵

"The corporate shield hinges upon the legal fiction that a corporation is a legal entity separate and apart from its owners, officers and directors. To maintain this legal fiction, you must treat the corporation like it is a separate entity" (Hughes, 2004). As a matter of practical implications, small business owners are probably particularly susceptible to mixing personal funds with corporate funds (and both they and their small corporations may easily become intertwined). It is imperative to maintain this separation, because once evidence shows that for all intents and purposes a small business owner is basically identifiable in transactions as one in the same as his or her corporation, or vice versa, the protection of the shield is lost.

Another common way to create problems for a business is to fail to acknowledge the corporate status both in terms of disclosure, but also with respect to other formalities such as entering contracts. As Hughes (2004) suggests:

You should properly identify the corporation at all times. For example, business cards and advertising should include the proper corporate name of your entity, including "Inc.", "Co.", "Corp.", or other appropriate monikers denoting a corporation. Your letterhead and stationery should include the same information. Last, but not least, any contracts entered into by the corporation must have the proper name including corporate designation. Signing a contract and not including the right name [or your corporation as the party to be bound by the agreement] is a very easy way to become personally liable for all breaches of contract.

Formalities also include "'corporate governance' rules [which] cover things such as board of directors meetings, capitalization requirements and reporting requirements" (Peckinpugh, 2000).

In light of an increasingly litigious environment, more organizations have recognized the need to take steps to protect their interests against veil piercing: "The holding company structure operates as an umbrella under which other companies...exist" (Gilpatrick, 2006). Conceptually, holding company configurations and parent-subsidary arrangements provide another layer of protection. As suggested by Wortham (1998), the notion of formalities is applicable to both small and larger organizations alike:

"Organization of a subsidiary should provide adequate insulation if steps are taken to ensure that the 'corporate veil' is not 'pierced' by lack of observance of corporate formalities at the subsidiary level. [But] excessively close arrangements (related to management and control) between a parent and its subsidiary increase the likelihood that the subsidiary will be viewed by courts as merely an agent or instrumentality of the parent."

In other words, "conducting a similar business in a similar location or having interlocking sets of officers, directors, and ownership can create problems" (Hughes, 2004).

We conclude our discussion about veil piercing prevention methods with an interesting quote which articulated the point of view held by authors who are evidently in the trenches representing corporate defendants. In an article entitled, Humanizing the deep pocket corporation, T. B. Williams and Dominick (1995) observed:

Corporations are often perceived to be greedy, impersonal and completely indifferent to the effects their activities have on society. To overcome this prejudice...[a corporate defense attorney] must essentially draw the corporate veil, presenting the corporation not as a faceless, single entity, but as a collection of fair, responsible and conscientious individuals.

We find the above approach particularly compelling because it is highly suggestive of a form of transparency that would normally be akin to honesty and innocence on the part of a corporate defendant that had behaved properly in the first place.

CONCLUSION AND IMPLICATIONS FOR ENTREPRENEURSHIP TEACHING, RESEARCH, AND PRACTICE

The authors of this paper have sought to add an important and needed contribution to the scholarly literature of entrepreneurship. Those in favor of piercing the corporate veil are often (at least from their own point of view) justified in their efforts. They also may be formidable in their wherewithal (e.g., banks attempting to collect) and commitment to doing so. Veil piercing efforts are driven

not only by the outcome of a single case, but also by the precedents that may be established, which will influence future litigation.

Many contemporary business and entrepreneurship books identify increasing globalization as a significant business trend (and even without textbook knowledge, we would add that it would be difficult for most individuals to remain unaware of this trend). However, particularly as it pertains to veil piercing (which is recognized doctrine in many nation-states), globalization has some additional implications. As observed by McConnaughay (1995):

One of the few predictable consequences of the increasing globalization of corporate conduct is a commensurate increase of litigation in the United States (and presumably elsewhere) involving corporate parties of multiple nationalities. Plaintiffs from abroad increasingly will seek to impose liability on US parents for the acts and obligations of their foreign subsidiaries, while plaintiffs resident in the United States increasingly will seek to impose liability on foreign parents for the acts and obligations of their US subsidiaries. These efforts frequently will involve the invocation of two related (and sometimes interchangeable) doctrines:

** piercing the corporate veil to obtain jurisdiction over a foreign corporate parent (or controlling shareholder); and*

** piercing the corporate veil to impose liability on a corporate parent (or controlling shareholder) for the acts or obligations of its subsidiary.*

Hence, changes in the environment foreshadow the likelihood of an even greater risk that future entrepreneurs (presently students) may encounter an even more complex morass of legal implications associated with their choice(s) of corporate form.

Entrepreneurship educators who may be laypersons in the area of law (as compared to practicing attorneys and legal scholars) may unwittingly contribute to creating a false sense of security about protections afforded under corporate forms in the course of providing instruction. This of course suggests content that is not only presently inadequate, but will be increasingly so in the future.

For the scholarly researcher in small business and entrepreneurship disciplines, as we have found, this paper will represent one of the first contributions of its kind to the literature. This suggests several opportunities for future research. First, is the obvious task of making further connections with the preexisting body of knowledge associated with well established legal scholars and their research. Second, we would suppose that small businesses and entrepreneurial firms may suffer from unique challenges in lacking sufficient access to corporate counsel, being more susceptible to mistakes and subsequent litigation, and more likely to forego formalities that are precisely those that will get them into real trouble. We expect this, but further research and empirical testing would aid in both defining the situation as it now exists (and subsequently addressing matters with practitioners and students who are would-be entrepreneurs).

Finally, as we have indicated, veil piercing is an evolving area and dynamic. Keeping up with changes and then correlating those changes with the concurrently evolving discipline of entrepreneurship is also a recommended course of action for any student, entrepreneurship educator, researcher, or practitioner.

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INTRAPRENEURSHIP: A REQUISITE FOR SUCCESS

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ABSTRACT

Many feel that “intrapreneurship” is an interesting concept, but one which is fraught with peril. The need for innovation within organizations is a topic of much debate today as entrepreneurship has finally caught the world’s attention. If entrepreneurial firms change the business paradigms and make us see products and services in a different manner, then why can’t existing organizations with their tremendous wealth and resources foster innovation much more readily?

They can and do, but intrapreneurship is not a concept accepted by all large organizations. In an effort to become more efficient and cost effective, the search for the new and untried is anathema. Those who wish to go where no man has gone before must innovate or they will not reach their goal.

INTRODUCTION

How do you make your company more innovative? How do IDEO and Google do this? How can you make a large organization intrapreneurial? Can it even be done? Absolutely! Here are our suggestions for organizing your company in order to enhance creativity and innovation. Escape the traditional thinking typically found in corporate settings and transform your organization’s ability to create break-through products and services!

WHAT IS INTRAPRENEURSHIP?

Intrapreneurship is a term coined by Burgelman in his 1983 dissertation (www.wikipedia August 24, 2007) and made prominent by Gifford Pinchot (1985) in his book, “Intrapreneuring: Why You Don’t Have to Leave the Corporation to Become an Entrepreneur.” Pinchot (1985) defines an intrapreneur as a “person who

focuses on innovation and creativity and who transforms a dream or an idea into a profitable venture, by operating within the organizational environment.”

Many feel that “intrapreneurship” is an interesting concept, but one which is fraught with peril. The need for innovation within organizations is a topic of much debate today as entrepreneurship has finally caught the world’s attention. If entrepreneurial firms change the business paradigms and make us see products and services in a different manner, then why can’t existing organizations with their tremendous wealth and resources foster innovation much more readily? Why, indeed?

ORGANIZATIONAL CHARACTERISTICS THAT ENCOURAGE INTRAPRENEURSHIP

The key to establishing an “intrapreneur-friendly” organization is to create an innovative working environment.(Intrapreneurship, answers.com August 24, 2007) Sounds simple, doesn’t it? Yet, in many large organizations the environment is already established. There are hierarchies, rules, procedures and the “right” way to do things to make the company more efficient. Careers can be destroyed by monetary losses and mistakes. Innovation is difficult under those conditions. Yet, as far back as 1988, Rule and Irwin theorized that one could create a culture of innovation through: 1) formation of intrapreneurial teams and task forces; 2) recruitment of new staff with new ideas; 3) application of strategic plans that focus on achieving innovation; and 4) establishment of internal research and development programs (Rule & Irwin, 1988).

Other keys to creating an intrapreneurial environment include the following: (Intrapreneurship, answers.com, August 24, 2007)

◆	Support from ownership and top management;
◆	Recognition that intrapreneurship is compatible to the existing culture;
◆	Communication channels that are open;
◆	Allocation of resources to the new innovations;
◆	Rewards for intrapreneurship; and,
◆	Follow through by the intrapreneurs in order to see the finished product.

While these are noble goals, do most organizations allow for these?

Three fundamental blocks to the above goals in organizations are the following: (Some thoughts..., 2007)

◆	Believing you already have “the right answer” (This prevents you from understanding possible alternative futures and choosing to create the one you most desire. The not invented here syndrome is alive and well in most large companies.);
◆	Taking life too seriously prevents one from exploring new ideas; and,
◆	Believing you are not creative prevents attempts which might result in failure (<i>Some thoughts....2007</i>).

Creativity and innovation must flourish if large companies are striving to create an environment conducive to intrapreneurship. Can that happen in your organization?

THE TEN COMMANDMENTS FOR INTRAPRENEURS

Pinchot (1985) in his seminal work on “Intrapreneuring” provides a list of rules for the intrapreneur striving in a large company to get his or her idea accepted. They are:

◆	Do any job needed to make your project work regardless of your job description;
◆	Share credit wisely;
◆	Remember, it is easier to ask for forgiveness than permission;
◆	Come to work each day willing to be fired;
◆	Ask for advice before asking for resources;
◆	Follow your intuition about people; build a team of the best;
◆	Build a quiet coalition for your idea; early publicity triggers the corporate immune system;

◆	Never bet on a race unless you are running in it;
◆	Be true to your goals, but realistic about ways to achieve them; and
◆	Honor your sponsors.
(Pinchot, 1985)	

This advice could be beneficial for anyone working in the corporate environment, but does it truly make an “intrapreneur friendly” workplace? We think not!

THE PRACTICE OF THE ART OF INTRAPRENEURSHIP

Kawasaki (2006) presented a more realistic set of commandments for the modern day “intrapreneur”. This series of practices might well allow us to intrapreneur. These rules are:

◆	Kill the cash cows (Allow for the fostering of new products and services funded by the cash cows of yesterday);
◆	Reboot your brain. ...Generally, you should do everything the opposite way from the tried and true existing ways of large companies (Building consensus and focus groups do not allow for originality in innovation. Customers can only tell you what they like or dislike about existing products. They cannot tell you what they think of your new ideas.);
◆	Find a separate building (Remove the intrapreneur from the daily activities of the company. This allows freedom to try various trials without the constraints of the organization. There is a requirement for freedom of thought, space and experimentation.);
◆	Hire infected people....It’s being infected with a love for what the team is doing.... It’s not work experience or educational background (Intuitive, creative people can come up with amazing ideas which can be commercializable, but may not fit well into the traditional bureaucracy of a large organization with its rules and procedures);

◆	Put the company first....as long as you are an employee, you have to do what's right for the company;
◆	Stay under the radar...you need to stay invisible as long as practicable...Make your bosses think it was their idea;
◆	Collect and share data (Be prepared for questions and be able to support your position for the nay sayers.); and,
◆	Dismantle when done....product teams will move into the mainstream of the company.
(The art of ..., 2007) (Parentheses are added by the authors)	

Again, the prescription may produce results, but this list, like Pinchot's is more about working around the system, rather than changing it. Note the command to "stay under the radar," which is similar to Pinchot's "build a quiet coalition." Why can't we change the organization?

INNOVATION IN LARGE ENTERPRISES

When one thinks of large companies and the access they have to research and development capital, one might conclude that most innovation comes from those companies. But time and again, we see large, successful companies engaging in *elaborative* innovation. They change the target market, add flavor, change the trade dressage, or change the size of their existing products rather than create new, original products. There is a statement which is expressed by Joel Barker (1993) and also by Andy Grove, former CEO of Intel which goes, "*Success sows the seeds of its own destruction*" (Grove, 1999). The adage refers to the tendency of the people in a successful enterprise to assume that they are successful because they have it right; they understand the market and they know what they are doing. Such an attitude can cause people to sit back and enjoy their success; to become mentally lazy; to assume that the future will be a reflection of the past. When they do, they tend to be passed by entrepreneurs.

Grove (1999) was willing as CEO of Intel to "cannibalize his own products" to stay ahead of the game. His strategy sacrificed returns by introducing the next generation of chip to the public before the earnings of the last had been fully

realized. He felt that in order for Intel to retain its 80% market share, it had to continue as the technology leader. As soon as he slowed development, another company would become the de facto standard and history has proven that he was right (Grove, 1999). Grove's successors either felt that the cost to stockholders of such a strategy was too great, or fell victim to their own success. Today, under new leadership, Intel has lost its market domination and much of its market share.

It is true that the majority of research and development expenditures do occur in large enterprises, but few of the really ground breaking innovations result from those efforts (Baumol, 2005). A report prepared by the U.S. Small Business Administration (1995) declared that the most important innovations of the Twentieth Century were developed by entrepreneurial enterprises (*The state of...*, 1994).

Why is it that underfunded, small businesses without marketing clout, without manufacturing resources, without personnel, without all of the accouterments of business, produce virtually all of the real breakthroughs? The answers relate to the people. So frequently we forget that "enterprise," "organization," "business," even "venture," are words that we have coined to describe the activities of individuals. No "business" ever decided to take any action. Every action, every decision, every effect of every organization is the result of the acts of one or more people. It is the motivation of these human decision makers that we must examine.

DRIVING FACTORS IN LARGE ENTERPRISES

Decisions in a large enterprise are made by managers. Managers are very different from entrepreneurs. Managers are paid salaries. There may be the opportunity for bonuses or profit sharing, but for the overwhelming majority of managers, the potential for serious wealth is not present as a motivating factor. As a result, managers are driven by numbers. As they make decisions, they must address the question, "*What actions will create the best internal rate of return for the company and create the best performance numbers for my unit?*"

If you remember how the internal rate of return (IRR) is calculated (or if you don't!), the returns must be adjusted for the risk. The greater the level of uncertainty about the potential for market acceptance of an innovation, the greater the mathematical risk attached to forecasted returns for that innovation. The greater the risk, the more forecasted returns are discounted in the formula. The result is that a minor innovation with limited forecasted returns and very low risk will fare better under traditional IRR analysis than a major innovation with forecasted high returns

and high risk. In other words, it is much safer to put peanut butter in a new jar than it is to launch a new sandwich spread as a companion for jam.

It is easy to understand the bias that is incorporated into the IRR formulae. Management scholars have never read Alfred Lord Tennyson! (www.phrases, 2007) In the realm of traditional business, it is *not* better to have loved and lost than never to have loved! It is far better not to take the chance. This bias is perpetuated by the evaluation system for management. Managers are literally driven by numbers because their performance is evaluated with them. If you want to progress in the company, then you need to make your numbers. When you meet with your superior each year, you come away with an understanding of the returns you should produce in your profit center, or the percentage of spending reduction you should achieve in your cost center. To progress in the company, you need to meet those numbers. If you exceed the numbers, that's great, but if you double or triple the numbers, there is rarely any serious difference in your career outcome. In other words, no one is going to double your salary because you doubled the expected returns for your department or division. In fact, they are far more likely to believe that the original expectations were too conservative and to saddle you with higher expected returns next year. Your reward for outstanding performance is likely to be an expectation for continued outstanding performance in the future coupled with a penalty for failure to achieve those results.

To complicate this picture even more, accounting rules mandate that expenditures for research and development (R&D) be expensed when incurred. We know that there is a lag time between the development of an innovation and any returns it might create and this lag time can be several years. Nevertheless, expenditures made in the search for innovations this year, are deducted this year. That means that the more you spend on research and development, the lower your returns will be, *whether your R&D is successful or not!*

The accounting issue is a significant one because it drives the calculation of the benchmark numbers for the managers of the world. This is one of the reasons for the popularity of joint venture research and development projects. The costs of a joint venture can be capitalized and charged off over a period of years, rather than being deducted in the current period. It is also a major driver of the interest in mergers and acquisitions. Costs of acquiring another enterprise are not operating expenses, so they do not affect the budgets or benchmarks of the managers making the daily decisions.

Driving Factors in Large Enterprise Innovation	
✓	Most large, successful companies engage in elaborative innovation only
✓	Major breakthroughs and significant original innovations occur in small enterprises
✓	Evaluation systems for managers stress internal rates of return and cost containment
✓	Research and development costs are charged against revenues this year whether successful or not
✓	Costs of merger or acquisition or joint venture are capitalized, not expensed
✓	Failure to achievement benchmark objectives is career limiting for a manager
✓	Reward systems for managers do not create significant returns for over-achievement of objectives
✓	Over-achievement tends to lead to higher expectations in future years
✓	The down side potential for failure tends to outweigh the upside potential for success
✓	Buying a small enterprise with a proven innovation is the least risky course of action

Can there be any wonder that managers see failure as career limiting? It *is* career limiting. Tom Kelley of IDEO told an apocryphal story about a senior level manager in large company who was presented with the world's first wireless mouse (Kellely & Littman, 2001). IDEO had developed that innovation when infrared transmitters began to be used on personal computer systems. The manager turned down the innovation saying, *"If it fails, I'll be known for the rest of my career as the guy with that stupid cordless mouse!"* (Kelley & Littman, 2001). Better not to adopt an unproven innovation, even one with such obvious potential, than to risk such a stigma! Right!

So, what is a wise manager to do? There is only one safe course of action! Make sure your research and development people concentrate on peanut butter jars, not peanut butter. Control your R&D expenses carefully. Then, watch the market place. Just watch! Sooner or later, some crazy entrepreneur will arise and *prove* the

viability of an innovation which you can use in your company. When that happens, you buy the little enterprise. It is likely to cost less to buy the little enterprise than it would to develop the innovation in house. More important, the cost of buying the venture won't be charged against your budget. Most important, buying a proven innovation is clearly the least risky course of action available!

There are exceptions, of course. A number of large enterprises have been successful at establishing an environment which really *does* encourage innovation. The secret is quite obvious; one must eschew the traditional management evaluation system. It requires commitment from the top levels of the organization and a willingness to resist pressure from shareholders.

There will be pressure from shareholders because innovation is wasteful! It produces failures which consume resources. It produces a playful atmosphere which is seemingly less efficient. In fact, nothing about innovation is efficient! That means that most of the time when we see a large firm supporting innovation among its people, that firm is producing such great returns for its shareholders that they don't resist the "waste of resources." If the returns to shareholders begin to lessen, top management will discover that supporting innovation becomes much more difficult, and even career threatening. In fairness to large enterprises, it is this external pressure from shareholders which stacks the deck against innovation despite the best intentions of well-meaning people.

CRAFTING AN ENVIRONMENT TO SUPPORT CREATIVITY

Typically, innovation does not occur on demand and yet that is what we often hear in the corridors of the large corporations. "*We need a new product, a new idea, a new market!*" "*Quick, let's brainstorm!*" While some of us have many ideas, others of us have fewer. Idea people usually are not as qualified to evaluate their ideas for commercialization. It is almost as if we have dreamers and doers and we need a marriage between the two to turn those dreams into reality. That is one of the reasons for the power of an entrepreneurial team. But, again, creativity does not happen at the snap of a finger. We need to have the right environment, the right culture, the right philosophy and the right people.

Most of the stories of truly innovative ventures have all of the best of these "*rights*." Take IDEO (Kellely & Littman, 2001), Mars (Brenner, 1999), Google (Vise & Malseed, (2005), and Southwest Airlines (Freiberg & Freiberg, 1996), as examples. They are quite successful companies who began much as you desire, some with more money and some with less, with a dream of providing the best

products or services that they could provide while having fun and being profitable and helping others.

Each of these ventures created an open environment: one in which questions were welcome, discussion was expected, ideas were respected and possibilities were challenged. The structure allowed for openness and communication with the founders. There were no ivory towers, but constant engagement and lots of fun. Open areas, not enclosed rooms, gave the opportunity for the cross-fertilization of ideas, much as that process originally occurred in Edison's *Invention Factory* (Beals, 1999).

Edison provides a wonderful role model for the marriage of innovation and entrepreneurship. A great practical joker, he encouraged fun, and experimentation, and had a healthy respect for those who had tried and failed. Many of the founders of the most innovative companies embraced failure as it not only showed initiative, but also resulted in learning on the part of the individuals who had attempted the impossible but discovered something else. Edison pursued invention for the purpose of creating commercializable products. His failure to find a market for his first invention, an electric vote counting machine, led him to vow never to waste time inventing things that people would not want to buy. (Beals, 1999). We suspect that he was still prey to the psychic rewards of innovation, but recognized the need to make money to keep his stream of innovations flowing. His remarkable career was more about entrepreneurship than invention as he created a network of companies to exploit the products that flowed from his "*invention factory*." Among these was the Edison General Electric Company, which became General Electric (Beals, 1999)..

If we examine the organizational environment which Edison pioneered and which modern firms have coopted to establish innovative firms, we can see a prescription which any organization, large or small, can follow to craft an environment to support creativity. In some organizations, changing the environment may be more difficult than in others, but these changes are within the grasp of any organization whose leadership has the will to persevere. This prescription, outlined in the following table, has been demonstrated to be effective in countless companies.

We do have one word of caution for would be adopters. Once you have made the change to this organizational structure, there is no going back! If you try to create an enclave to support innovation following our prescription, then reintegrate the people into the firm, those people will leave you! They will not be able to tolerate the return to a traditional corporate world. Indeed, in our estimation

the only reason that creative people do exist in the traditional corporate world is that they have never really experienced the joy of a truly creative environment.

Crafting an Environment to Support Creativity	
✓	Employ open spaces, not offices or cubicles, so that people interact freely and continuously
✓	Foster an environment of playfulness and fun
✓	Create teams and discussion groups to explore ideas; use both sexes and widely diverse backgrounds
✓	Forbid negative thinking; forbid critical thinking; forbid judgmental thinking; encourage wild ideas
✓	Embrace and laugh about failure; celebrate successes
✓	Eliminate numbers from evaluation systems and create upside potential without its corollary
✓	Focus on having fun; never focus on outcomes

Can you change your organization? Can you craft this supportive environment? With the support and belief of top management, you absolutely can! One of the adages which seems to be responsible for the immense success of Stanford University graduates has become a favorite of ours. The command is to “...create a healthy disregard for the impossible” (Vise & Malseed, 2005). With such direction, how could one not innovate!

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