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THE ENTREPRENEURIAL EXECUTIVE

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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.

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

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

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SMALL BUSINESS AT THE FOOT OF THE LEGAL MUSE: INTERPRETING SUPREME COURT CASES AND THEIR EFFECTS

Stephanie Huneycutt Bardwell, Christopher Newport University

ABSTRACT

Decisions and dicta of the United States Supreme Court provide direct and vivid guidance to business interests, not only in the United States, but across the globe. Large firms use general counsel to provide analysis of significant USSC cases, as well as landmark decisions in key jurisdictions like New York and California. This important case law analysis for large corporations is perceived as a non-essential or unaffordable luxury for small businesses. This paper promotes the use and implementation of LIDM, (Legal Insight Decision Making) as a tool to achieve improved business performance for small business and entrepreneurs; it offers a singularly focused review and preview of business related matters in the current term of the USSC and emphasizes the effect upon small business.

INTRODUCTION AND LITERATURE REVIEW

Small businesses are less likely and less able to navigate legal complexities than multi-national or large corporations for three simple reasons: A small business is less likely to have an expert legal advocate or in-house legal counselor, is presumed to be less likely to be subjected to enforcement of the governing regulations yet bears a disproportionate share of the federal regulatory burden (Crain, Hopkins 2001), and is less likely to be able to afford the time, expertise or expense of lobbying for or against legislation. In fact, the best advocate for the small business owner is typically not an individual legal advisor or attorney, but is likely the Office of Advocacy of the SBA.

The Office of Advocacy of the SBA provides extensive data and guidance related to entrepreneurship, job creation, minority and women owned business, banking, lending and credit practices, the environment, venture capitalism and many other important topics. The SBA commissions, funds and publishes research on those topics which are so important to small business interests each year. One important legal topic is the issue of regulatory burdens upon small businesses; in the research triangle of North Carolina, the private consulting firm Management Research and Planning Corporation (MRPC, 2002) investigated the means by which states attempted to piggyback states rules onto the federal Regulatory Flexibility Act. The consultants investigated whether states were effective in alleviating the regulatory burden falling on small businesses. The report concluded that only five states, Virginia, California, New York, Arizona and Illinois were effective in reducing federal regulatory burdens on their residents. However, even the passage of the federal Regulatory Flexibility Act and handmaiden bills like Executive Order 12866 and 13272 which were designed to diminish the federal regulatory burdens on small businesses, cannot fully correct the hefty and disproportionate burden of legal compliance that falls upon small businesses.

Cultivation of knowledge of legal cases related to business law requires virtual "signing up on the USSC dance card" to monitor cases under review. Small business and entrepreneurship educators who desire to further the interests of small business owners, as well as consultants, practitioners and educators can utilize a simple program to analyze the meaning of these landmark cases. It is then possible to transmit that understanding to the discipline by publishing research dedicated to the practice of advocacy for small business and all business.

Small business management experts and some scholars have recognized that familiarity with laws and regulations which have an impact upon business decisions is sometimes unrelated to decision making (Van Auken, Kauffmann and Herrmann 2009). In a remarkable study of owners' familiarity with Bankruptcy laws and their relation to capital acquisition, Van Auken et al recognized that although information is available, small firms may not have full access to the information nor perhaps do the consultants who advise them. Although the study was confined to Iowa businesses, the findings are likely to be applicable to multiple jurisdictions with similar state rules of bankruptcy exemptions, asset protection rules and states which are deed of trust states. Importantly, Van Auken et al conclude that "understanding bankruptcy laws is important to owners, consultants and policy makers." (p.35). It is significant that bankruptcy laws are exclusively federal in jurisdiction in spite of the fact that a wide variety of state customized rules on asset protection, homestead exemption amounts, etc. can lead to extreme disparity in application and results.

The data available in government repositories is a virtual goldmine for scholars who are attempting to ascertain the causes of small business success and failure and the effect of regulations on small business. The study of the burden of federal regulations upon small business has been effectively studied by Crain, W.M. and others in successive reports 1995, 2001, and 2005 defining the disproportional cost of federal regulations upon small business.

In each successive study, regulatory and paperwork burdens on small business were found to be "more onerous" (Crain 2005). Crain concluded in his 2005 study that environmental and tax compliance regulations were the worst offenders ; he found that compliance with environmental regulations costs 364% more in small firms than large firms and that tax compliance was 67% more costly to small firms than large firms.

In a very thorough study measuring the burden of tax obligations imposed on small business owners at the time of their bankruptcy filing, Efrat found that small business owner- bankrupt petitioners were twice as likely as consumer-bankrupt petitioners to owe tax debts (Efrat 2008). He found that overall, 30% of petitioners reported owing tax debt and individual entrepreneurs reported owing tax debt more often than small business entities. This study included only 5 federal judicial districts (California, Tennessee, Pennsylvania, Illinois and Texas) but included almost 2,000 bankruptcy schedules filed by both individuals and entities. The data covered petitions filed under the changes in bankruptcy after October 17, 2005 by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

According to leading economists, the small business sector is an essential element of the US economy (Liao, J., Welsch, H., Moutray, C. 2008/2009) and continues to be a significant influence especially in times of economic uncertainty. In times of economic uncertainty some scholars have called for policymakers to apply a framework that accounts for predicable behaviors under known or anticipated circumstances. Economists concerned with monetary policy call for the application of a monetary framework to navigate the "sea of uncertainty" (Svensson, L. and Williams, N. 2008) perhaps to permit a fuller perception of the factors which drive success or failure and ultimately contribute to economic stability. The business disciplines routinely propose, test, criticize or justify discipline specific models to enlighten and improve organizational learning and we might find "learning and renewing to be common themes."(Hoy 2008). Studies of franchise arrangements and entrepreneurial failure also suggest that agency law and contract design may play a role in business success or failure (Michael, Combs 2008). There is grudging recognition that knowledge of information and adequate exploitation of that information are two separate issues. There is evidence (Moutray 2008), as revealed in the U.S. Department of Educations' data series called "Baccalaureate & Beyond", which implies that collegiate education and choice of major, especially management, may not be determinative of eventual employment choices; and many scholars, may come to Moutray's insightful observation that entrepreneurship education might best be served across the curriculum.

In all cases, as stated succinctly by Fiore and Lussier, folks want to know their chances of successfully creating wealth (Fiore, R.A. and Lussier 2008/2009). The models for calculating and determining this likelihood vary, but most models focus on age, experience, education, organization structure, capitalization, personality type, type of business, to name a few- however, most predictive and analytical models omit the (obvious) factor of legal knowledge.

If integrating entrepreneurship with strategy to enhance business performance is as desirable as leading scholars surmise (Morris, Kuratko and Covin 2008) and strategic entrepreneurship lessons are relevant to small business in general, then the inclusion of legal knowledge and use of legal strategies must become a part of this emerging concept (Kuratko and Audretsch 2009). Even pioneers of strategy matrix modeling, Sonfield and Lussier, who created an entrepreneurial matrix to measure risk and innovation (Sonfield and Lussier 1997), might envision the competitive advantage in using the LIDM model to diminish risk and enhance competitive advantage.

As the forum of last resort in the US, the decisions from our nine justices provide final interpretations of the supreme laws of the land. Since the mid-1970's, a diminishing number of business cases have been selected for high court review each year. For example, from the elite annual crop of controversial candidates in 2009, only 4 cases directly involve business interests. This small number has advantages; there is no data overload at the USSC level. If the cases are finite and public, then the published legal decisions and dicta can be gathered, analyzed and formulated into an effective part of all business strategy models. This new use and analysis of court uttered legal information is called Legal Insight Decision Making (Bardwell 2009) and it can be effectively researched at lower levels of the judiciary and in multiple judicial forums and venues. LIDM requires the creation of an annual audit for upcoming legal issues which should coincide with the US Supreme Court term; i.e. - create the convenient "Legal Year" of October to October. Information necessary to determine which cases are significant and might be granted certiorari is eventually made public and is available through several methods. The author's preferred method is described for the sake of simplicity.

CREATING THE LIDM MODEL

Step 1: Select Hot Circuits

Identify recalcitrant Circuits and include the circuit in which your business interests reside.

Step 2: Select Hot Legislative Change Topics

Identify legislative changes and add two years to permit the appeals process to mature

Step 3: Select Hot Economic Topics

a. Identify topics covered in multiple issues in the WSJ, NYT, LAT, WP related to industry performance and add 6 months to one year for trickledown effect upon small business/entrepreneurs
b. Identify topics funded by SBA over past 2 years

Step 4: Select Hot Public Topics

Identify abusive ethical or professional breach behaviors covered in popular media and determine if federal regulations govern such behaviors and add 6 months to 1 year for resultant civil or criminal prosecutions

Step 5: Map the Intersection of steps 1-4 to plot future problems

Step 6: Select USSC cases related to Step 5 and granted cert. to monitor

Step 7: Review USSC case opinions

a. Overt issues which will surface again: split decisions and dissents
b. Unambiguous decisions –per curium or unanimous
c. Track remands

Step 8: Extract key lessons from Step 7 and apply to business/educational/entrepreneurial interests

HYPOTHESES AND SIGNIFICANT CASES IN BRIEF

Atlantic Sounding Co., Inc. versus Townsend U.S. Sup. Ct. June 25, 2009 General maritime law permits injured seaman to claim common law punitive damages for employer's allegedly willful and arbitrary failure to provide maintenance & cure (Thomas, J.)

Caperton versus A.T. Massey Coal Co., Inc. U.S. Sup. Ct. June 08, 2009 determined that State Supreme Court judge elected by state voters should have recused himself due to financial contributions from person whose case was soon to be heard (Kennedy, J.)

Montejo versus Louisiana- U.S. Sup. Ct. May 26, 2009 establishes police are no longer required to follow *Michigan v. Jackson* rule that they refrain from initiating questioning after suspect has invoked right to counsel (Scalia J.)

AT&T Corporation versus Hulteen U.S. Sup. Ct. May 18, 2009 found employer did not *per se* violate Pregnancy Discrimination Act by paying pension benefits according to calculation giving less retirement credit for pregnancy leave than for medical leave generally (Souter, J.)

Arthur Andersen LLP versus Carlisle U.S. Sup. Ct. May 04, 2009 agreed the Court of Appeals had jurisdiction to review district court's denial of request under §3 of Federal Arbitration Act to stay action which could have been referred to arbitration under written agreement (Scalia, J.)

Burlington Northern & Santa Fe Railway Company versus United States U.S. Sup. Ct. May 04, 2009 decided pesticide manufacturer/seller was not liable (as "arranger") for CERCLA cleanup costs incurred in decontaminating soil and ground water where chemicals were spilled during transfers and deliveries to agricultural chemical distributor/purchaser (Stevens, J.)

Entergy Corporation versus Riverkeeper U.S. Sup. Ct. April 01, 2009 reversed the U.S. Court of Appeals for the 2nd Circuit in consolidated cases concerning regulations adopted by the EPA under Section 316(b) of the Clean Water Act, 33 U.S.C. §1326(b). Environmental groups and various states challenged the regulations, and the 2nd Circuit set them aside. The issue on appeal was whether the EPA was permitted to use a cost-benefit analysis which the 2nd Circuit held it was not allowed to use. Reversing, the Supreme Court held that the EPA permissibly relied on cost-benefit analysis.

Gross versus FBL Financial Services, Inc. U.S. Sup. Ct. June 18, 2009 alters burden on the plaintiff bringing an ADEA disparate-treatment claim. Plaintiff must prove that age is the *decisive factor motivating the employer's actions.* It is not sufficient that age is among the factors; thus "mixed motive cases" are effectively losers! Plaintiff must establish by a preponderance of evidence that age was the decisive "but-for" cause of the challenged adverse employment action (Thomas, J.)

14Penn Plaza LLC versus Pyett U.S. Sup. Ct. April 01, 2009 reversed the U.S. Court of Appeals for the 2nd Circuit in a case considering whether a provision in a collective-bargaining agreement that clearly and unmistakably required union members to arbitrate claims arising under the Age Discrimination in Employment Act of 1967 was enforceable. The 2nd Circuit held that the Supreme Court's decision in Alexander v. Gardner-Denver Co. (1974), forbid enforcement of such arbitration provisions. The Supreme Court disagreed with the 2nd Circuit, instead holding that a provision in a collective-bargaining agreement that clearly and unmistakably required union members to arbitrate ADEA claims is enforceable as a matter of federal law.

Vaden versus Discover Bank U.S. Sup. Ct. March 09, 2009 reverses the U.S. Court of Appeals for the 4th Circuit in a case considering Section 4 of the Federal Arbitration Act, which authorizes a U.S. district court to entertain a petition to compel arbitration if the court would have jurisdiction, "save for [the arbitration] agreement," over "a suit arising out of the controversy between the parties." At issue was (a) whether a district court, if asked to compel arbitration pursuant to Section 4, should "look through" the petition and grant the requested relief if the court would have federal-question jurisdiction over the underlying controversy and (b) if the answer to question (a) is yes, whether a district court may exercise jurisdiction over a Section 4 petition when the petitioner's complaint rests on state law but an actual or potential counterclaim rests on federal law. The Court held that a federal court may "look through" a Section 4 petition to determine whether it is predicated on a controversy that "arises under" federal law; in keeping with the well-pleaded complaint rule as amplified in Holmes Group, Inc. v. Vornado Air Circulation Systems, Inc. (2002). However, the Court stated that a federal court may not entertain a Section 4 petition based on the contents of a counterclaim when the whole controversy between the parties does not qualify for federal-court adjudication.

United States versus Eurodif S.A. U.S. Sup. Ct. January 26, 2009 reversed the U.S. Court of Appeals for the Federal Circuit in a case considering Section 731 of the Tariff Act of 1930 (Act) which calls for "anti-dumping" duties on "foreign merchandise" sold in the United States at "less than its fair value," but does affect international sales of services. At issue was the application of the anti-dumping provision to imports of low enriched uranium, a highly processed derivative of natural uranium used as nuclear fuel, in situations where domestic utilities contracted to obtain low enriched uranium for cash plus unenriched uranium delivered to a foreign enricher. Although the parties' contracts called these transactions *sales* of uranium enrichment services, the U.S. Commerce Department treated them as sales of "foreign *merchandise*" subject to the anti-dumping provision. The Court held that the Commerce Department's view of these transactions as sales of goods rather than of services was a permissible interpretation and application of the act.

Crawford versus Metropolitan Govt. of Nashville and Davidson County, Tennessee U.S. Sup. Ct. January 26, 2009 reversed the U.S. Court of Appeals for the 6th Circuit in a case considering whether Title VII of the Civil Rights Act of 1964 extends to protect an employee who speaks out about discrimination not on her own initiative, but in responding to questions during an employer's internal investigation. The Supreme Court held that it does, noting that the word "oppose" in the "opposition clause" of Title VII, 42 U. S. C. §2000e3(a), is statutorily undefined. Thus, the Court held, the word carries its ordinary dictionary meaning and covers the petitioner's statement in the present case.

Kennedy versus Plan Administrator for DuPont Savings and Investment Plan U.S. Sup. Ct. January 26, 2009 affirmed the U.S. Court of Appeals for the 5th Circuit in a case considering the Employee Retirement Income Security Act of 1974, which generally obligates administrators to manage ERISA plans "in accordance with the documents and instruments governing" them. At a more specific level, ERISA requires covered pension benefit plans to "provide that benefits ...under the plan may not be assigned or alienated," but this bar on alienation and assignment does not apply to qualified domestic relations orders. The question before the Court was whether the terms of a limitation on assignment or alienation invalidated the act of a divorced spouse, the designated beneficiary under her ex-husband's ERISA pension plan, who purported to waive her entitlement by a federal common law waiver embodied in a divorce decree that was not a qualified domestic relations order. The Supreme Court held (a) that such a waiver is not rendered invalid by the text of the anti-alienation provision, but also (b) that the plan administrator properly disregarded the waiver owing to its conflict with the designation made by the former husband in accordance with plan documents.

CONCLUSION

Recognizing the significance of these cases and interpreting the results of the cases at question is an essential part of strategic planning for large firms; as a strategy of war, this knowledge permits enhanced tactics and strategies only to those businesses aware of the consequences of judicial pronouncements.

However, these USSC decisions also provide a competitive advantage to small businesses, entrepreneurs, owners, consultants and educators. Legal Insight Decision Making proposes a nuanced change in the attitudes of entrepreneurs and educators towards the lessons found within the court's words. It is time to recognize the value of polishing the insights gleaned from these select gems and incorporating these lessons to entrepreneurial and small business strategic models.

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PRE-START-UP PREPARATIONS: WHY THE BUSINESS PLAN ISN'T ALWAYS WRITTEN

Edward D. Bewayo, Montclair State University

ABSTRACT

Probably the best way to prepare for a business start-up is to formulate a business plan. However, only a small fraction of entrepreneurs start out with business plans. This paper summarizes the findings of a study covering 355 small business owners in New Jersey who were interviewed by senior undergraduate students on the activities they undertook in preparation for new business launches.

Fifty percent of the 355 business owners interviewed claimed to have prepared business plans for their start-ups. This particularly high percentage is explained in the paper. The study found that preparing business plans correlated with the usage of external financing and that bank loans mostly went to business owners with business plans. However, a large majority of the business owners who had prepared business plans had found their business plans to be useful more as guidelines for operating their businesses than as tools for raising business funds.

The most important reasons for not preparing business plans were not having to use bank financing and being highly experienced in the entrepreneurs' lines of business. Fifty percent of business owners with industry/business experience didn't prepare business plans, and frequently saw their experience to be a substitute for business plans. However, the other half of business owners with business experience did prepare business plans.

The interviewed business owners, even when they didn't prepare business plans, undertook a variety of market-related non-documented activities, especially investigating the competition. These non-documented pre-start-up activities are often referred to as intuitive planning.

INTRODUCTION

Herman Holtz (1994) pointed out "that everyone talks about the need for a business plan but most people starting … small businesses …do nothing about it." There doesn't appear to be any person who has systematically determined the percentage of entrepreneurs who start out with business plans. Available estimates have tended to relate to strategic plans for ongoing small businesses. See, for example, Rue and Ibrahim (1998; Karger, 1996; Mazzarol, 2001; Sexton & Van Auken, 1985). As far as new small businesses go, Siropolis (1997) guess-estimated that only about 5% of them start out with business plans.There are many reasons why most start-up entrepreneurs do not write business plans. One common reason is the view that business plans are intended only for raising business funds, implying therefore that if an entrepreneur doesn't need external financing, there is no need to prepare a business plan. Although existing literature doesn't seem to support the view that business plans are written exclusively for raising business funds, there is some support for the view that the single most important reason for writing business plans is to attract external financing (Kaplan & Warren, 2007). However, according to Zimmerer & Scarborough (1996) and Ford, Bornstein & Pruitt (2007), the first and foremost purpose of business plans is to provide guidelines for successfully managing a business. Raising capital is a secondary purpose.

Another common reason why most entrepreneurs do not write business plans is what David Bangs (1993) called the "Man of Action Problem", the preference for doing things instead of thinking about them or even writing about them. This view about business plans reflects the "Just Do It" philosophy, made popular by entertainer-turned entrepreneur, Wally "Famous" Amos (1999). He argued that formal business plans take too much time and require too much skill. Moreover, the analysis that goes into business plans may predict negative outcomes. Such outcomes could prevent the would-be entrepreneur from actually becoming one. Mazzarol (2001) has distinguished between formal business plans and the process of planning. Almost all start-up entrepreneurs undertake some planning activities, which may fall under what Van Auken & Neeley call "undocumented pre-launch preparations" (2000). Start-up entrepreneurs, often intuitively and informally, develop a sense of an unsatisfied need in the market and the relevant customer segment that can be helped to satisfy their need. They then proceed to satisfy the need, often a small group of customers at a time. This intuitive planning is good enough for the overwhelming majority of start-up entrepreneurs (Mazzarol, 2001; Sudikoff, 1994; Gwendron, 2004). Like Wally "Famous" Amos, most start-up entrepreneurs informally ask themselves some tough questions, but they just don't document the answers they get in formal business plans.

This study examines the nature of pre-start-up preparations to determine when such preparations get documented into formal business plans and when they remain undocumented and at an intuitive level. For those start-up entrepreneurs who do not prepare business plans, what are the specific reasons why they don't prepare business plans? What is the nature of intuitive planning that some start-up entrepreneurs use.

The study also examines the value of business plans to those who prepare them. While it is generally known that most business plans are written for raising business funds, what other purposes do business plans serve? How do these other purposes stack up with the purpose of raising business funds?

METHODS

A common activity textbooks ask students to do is to find out for themselves what entrepreneurs do in way of preparing themselves for their ventures (Longenecker, Moore, Petty & Palich, 2003; Zimmerer & Scarbough, 1997; Ryan & Hiduka, 2006). Following this hint, senior undergraduate students taking a course on Entrepreneurship and Small Business Management at a college in New Jersey were asked to conduct interviews with small business owners who had started their businesses in the last ten years. A 15-item semi-structured questionnaire was prepared for the students. The full questionnaire is available from the author. The initial key question was: What key steps did you take to determine the likelihood of success for your business prior to opening day? While students were allowed and expected to ask follow-up questions regarding any steps indicated by the business owner, they were required to limit their reports to five key steps given by the business owner. In addition, the students were required to report on each step separately and in no more than four sentences on each step. These strictures were intended to facilitate content analysis of interviewees' responses.

Although it was reasonable to assume that some of the business owners interviewed would mention the business plan as one of the steps or the only step they had used to assess the likelihood of business success, the students were required to specifically ask whether a business plan had been prepared, whether the entrepreneur him/herself had prepared the business plan, and whether the entrepreneur had found the business plan useful, including why and why not. In an attempt to find out whether business plans are prepared primarily for raising business funds, as is commonly assumed, the students also asked whether the entrepreneur had obtained bank/SBA loan financing and financing from family and friends.

Further, since it is commonly known that prior work experience greatly determines whether or not one starts a business and what kind of business one starts (Holmes, 2008; Perry, 2001), it was anticipated that many business owners were likely to mention having or acquiring relevant business and industry experience as one of the steps or the only step they took to assess the likelihood of success of their proposed start- ups. To tap this information more directly, the interview questionnaire contained questions on what the entrepreneur was doing before starting the business and whether there was any specific trigger that led to the decision to start the business.

The students interviewed 378 business owners between 2005 and 2007. Twenty three interviews were excluded from this study because the business owners were franchisees where franchisors had provided substantial preparatory support to the would-be entrepreneurs. Still other excluded interviews contained too many unanswered questions, i.e., five or more interview questions were left blank because the business owner refused to provide answers to questions, or the answers to questions were too indefinite. So, the total number of student interviews examined for this study is 355. Table 1 provides some demographic information about the 355 business owners and businesses covered in this paper.

An initial review by the author of 30 completed questionnaires resulted in the creation of the guidance sheet for coding data from the completed questionnaires by a graduate student. The same graduate student keyed the data into SPSS software. The analysis of the data is limited to descriptive statistics, including cross tabulations.

Table 1: Demographic Information				
Business Type	Service	Retail	Manufacturing	Total
Number of Businesses	237 (67%)	107 (30%)	10 (3%)	354 (100%) 1*
Business Age	1-3 Yrs	4-6 Yrs	7-10 Yrs	Total
Number of Businesses	93 (27%)	84 (24%)	167 (49%)	344 (100%) 11*
Business Technology	Low/Medium	High	Total	
Number of Businesses	255 (72%)	95 (27%)	350 (100%) 5*	
Owner's Gender	Male	Female	Total	
Number of Businesses	301 (85%)	52 (15%)	353 (100%) 2*	
Business Size	0 to 5 employees	6 to 15 employees	over 15 employees	Total
Number of Businesses	176 (54%)	100 (30%)	53 (16%)	331 (100%) 24*
*Cases with missing or unclassifiable responses.				

FINDINGS

The responses to the question: "What key steps did you take to determine the likelihood of success for your business?" generated a wide range of responses. In the findings being reported in this paper we focus on responses related to entrepreneurs' business/industry competencies, investigation of markets and marketing strategies, preparation of business plans, bank financing, value of business plans, and reasons why business plans aren't always written.

Entrepreneur's Business/Industry Competencies

An entire 221, 62%, of the 355 business owners interviewed referred to their industry/business knowledge and experience as a key preparatory step toward the success of their business start-ups. These business owners were operating in the same lines of business as their previous employers, sometimes family members, for example, a landscaping business owner who previously worked for a large landscaping company. It is highly likely that most of these business owners "incubated" their business ideas while still with their previous employers. They had thought about going into business for long periods of time before and during their previous employment. Nine of these former employees went into business after being downsized by their employers. One hundred and fifty of the 221 business owners who capitalized on their industry/business experience when starting up were in service-related businesses. See Table 2. This is 63% of 237 business owners interviewed who operated service-related businesses. The comparable percentage for retail business owners was 60%. That for manufacturing business owners was 70%. Thus, a great number of start-up entrepreneurs interviewed relied on their employment and industry experience to gauge their likelihood for success in their business endeavors.

Table 2: Experience and Line of Industry/Business					
Type of Business	Sources of Industry/Business Experience				
	Employment	Education	Hobbies	No Experience	Total
Service	150 (67%)	18 (18%)	17 (8%)	39 (17%)	224 (100%)
Retail	64 (61%)	6 (6%)	10 (10%)	25 (24%)	105 (101%)
Mdnufacturing	7 (70%)	1 (10%)	1 (10%)	1 (10%)	10 (100%)
Total	221 (65%)	25 (7%)	28 (8%)	65 (19%)	339 (100%)

Business knowledge and experience are typically acquired from employment situations. But sometimes valuable experience, especially technical experience, can also be acquired through schooling and training, e.g., opening a restaurant after culinary school, or a beauty shop after cosmetology school, and hobbies. As can be seen from Table 2, 53 interviewed business owners had these types of knowledge and experience and considered such knowledge and experience as a form of preparation for venturing into their own businesses. Acquisition of appropriate business knowledge and experience should perhaps be considered as part of the intuitive planning that precedes written business plans and is often considered a substitute for them. In a later section we look at the relationship between business knowledge/experience and the propensity for written business plans.

Investigating Markets and Marketing Strategies

Clearly, and consistent with theory, most start-up entrepreneurs examine their experiences from work, education and hobbies before venturing out. Partly due to these experiences and partly due to innate intelligence and a natural tendency to do some due diligence and minimize risk, most start-up entrepreneurs also examine certain business success factors, especially factors related to the markets they plan to serve. As indicated earlier, one of the key interview questions was: What key steps did you take to determine the likelihood of success for your business prior to opening day? It was anticipated that many of the steps were going to be about markets and marketing.

Of the 355 business owners interviewed, 282, 79%, of them referred to key marketing factors in terms of the steps they had taken to assess the likelihood of success for their business ventures. Table 3 shows the marketing factors that were mentioned by business owners. As can be seen from Table 4, and as should be expected, some business owners mentioned more marketing factors than others did.

Table3: Marketing Factors Evaluated	
Marketing Factors	Frequencies of Being Mentioned
Competition/location	163 (31%)
Markenting Research*	152 (29%)
Advertising	73 (14%)
Contacts in the Market	49 (9%)
Customer Targeting	44 (8%)
Availability of Suppliers and Retailers	38 (7%)
Trade Shows andTrade Associations	10 (2%)
All marketing Factors Mentioned	529 (100%)
* Indicated by references to typical primary and secondary tools of marketing research, such as surveys and examining published market and industry data.	

Table 4: Differences in Emphasis on Marketing Factors	
Marketing Factors	Business Owners Mentioning Factors
3 or more factors	67 (19%)
2 factors	121 (34%)
1 factor	94 (27%)
None	73 (21%)
Total	355 (100%)

Most business and marketing decisions are dictated by competition in the location of a business. Zahra, Neubaum & El-hagrassey (2002) stated that understanding competition is the key to business success. Bradley (2002), who was investigating factors that had led to bankruptcies, also found that well over 50% of the surveyed business owners who had filed for bankruptcy had checked out the competitive environment. It is, therefore, not surprising that competition and location, coupled together, was the single most frequently cited marketing factor considered or evaluated prior to business opening day, as can be seen from Table 3. It is possible that some of the business owners who did not mention competition believed that they faced no competition, even though this is always a mistake. But it is also possible that knowledge about competition and competitive factors is part of industry/business knowledge and experience for those who had such knowledge and experience. Accordingly, they might not have felt compelled to talk about competition. Indeed, of the 221 business owners who regarded their employment/industry experience as a or the reason for their potential business success, an entire 54% didn't mention competition. The corresponding number for the entire sample was only 46%.

Table 3 shows that 152 of the interviewed business owners claimed to have conducted marketing research. Content analysis keyed on phrases and sentences such as "marketing research", "I researched the market", "surveys were conducted", "there was a focus group", "analyzing industry and demographic data", and "test marketing a product". Obviously, in many cases marketing research included an investigation of competition and location factors. Indeed, 55% of the business owners who stated that they had done market research also specifically stated that they had examined competition and location.

Only 39, 15%, of the 257 business owners in service-related businesses who were interviewed mentioned three or more marketing factors as steps they had taken to assess the likelihood of success for their proposed businesses. The comparable figure for small retailers was 25%. Retailers were, therefore, more concerned about marketing factors than were service-related business operators. Alternatively, 21% of the business owners in services didn't mention any marketing factors as steps they had taken to assess the likelihood of success for their proposed businesses. The comparable number for retail business owners was 14%. The rather obvious reason for this difference between the service and retail industries in terms of the emphasis on marketing factors appears to be that service businesses are, in general, the least expensive to start and operate. Business failure in service businesses is not as costly as it is in retail businesses. Headd (2003) found that service businesses and retail businesses differed in terms of failure rates. Retailers failed more than service businesses. He suggested that retailers face a more competitive environment than service businesses do. There is, therefore, a stronger need for market due diligence in the retailing industry than in the services industry.

Business Plans

To most business consultants, educators and lending/financing authorities, the business plan is the ultimate in pre-start-up preparations. The interview questionnaire, therefore, solicited information on business plans both directly and indirectly. Directly, there was a question on whether the business owner had prepared a business plan prior to opening day, and if not why not. Indirectly, the question on what steps the entrepreneur had taken to assess the likelihood for success in his/her business potentially alluded to the business plan.

One hundred and seventy-eight, 50%, of the 355 business owners interviewed claimed to have prepared business plans prior to opening their businesses. This is a relatively high percentage, given the fact that the percentage has been estimated to be as low as 5% (Siropolis, 1997). One possible explanation for this is that the business owners interviewed for this study were conveniently selected, what is known as a convenience sample. Only business owners who agreed to be interviewed were interviewed. There was a possibility of self selection bias; people who agreed to be interviewed might have been more sophisticated and/or educated than average. Business planning and personal sophistication are said to be positively correlated (Mazzarol, 2001; Gibson & Cassar, 2002). Second, the concept of the business plan is notoriously loose. Students had been instructed to determine the quality of the business plan by comparing it to the outline suggested in a textbook by Longenecker et al (2003) which was being used in the class they were taking. The students were also referred to the business plan framework used by Perry in his article "The Relationship Between Business Plans and Business Success and Failure" (2001). Students generally found that "comprehensive business plans" were rarely prepared. Most business plans were of the "summary" or "dehydrated" type (Longenecker et al, 2003). In terms of Perry's model (2001), very few business plans covered more than two planning areas. This was consistent with Perry's findings. In his sample of 304 failed and non-failed businesses; only 37% had business plans and on average covered less than 2 of the 5 areas included in Perry's questionnaire. Given the strong consensus among commentators on business plans that there is no one best way to construct a business plan (Gumpert, 1997; Ryan & Hiduke, 2006; Ford, Bornstein & Pruitt, 2007), in this study claims of business plans were taken at their face value, provided it was also claimed that the business plan was a written document. In the interviews students were advised to request to see the business plan document if one had been prepared, and 52 students were able to see the actual business plans. In other cases the business owners didn't show their business plans but were able to describe them.

It is arguable that marketing factors (marketing research and marketing plans) constitute the heart of the business plan (Siropolis, 1997). Emphasis on marketing factors was, therefore, expected among the business owners who had prepared business plans. However, 27, 15%, of the 178 business owners who started out with business plans included no marketing factors among the steps they had taken to assess the likelihood of success for their businesses. It is noteworthy, however, that 43, 25%, of the 172 business owners without business plans also hadn't investigated marketing factors. Table 5 includes information on the relative prevalence of marketing concerns among the business owners with business plans and those without business plans. The marketing emphasis was higher among "planners" than among "non-planners." Alternatively, "planners" were more likely to have investigated marketing factors than "non-planners."

Table 5: Business Plans and Marketing Factors

Business Owners With	Marketing Factors Mentioned				
	3 or more factors	2 factors	1 factor	None mentioned	Total
Business Plan	33 (19%)	69 (39%)	49(28%)	27 (15%)*	178 (101%)
No Business Plan	34 (20%)	50 (29%)	45(26%)	43 (25%)*	172 (100%)
Total	67	119	94	70	350

* Only 15% of the "planners" mentioned no marketing factors at all.
The figure for "non-planners is 25%.

Business Plans and Bank Loans

In the minds of many business owners, if not most, the key reason for preparing business plans is to get business financing (Kaplan & Warren, 2007). Table 6 shows that of the 60 interviewed business owners who got SBA/bank loans for their businesses, 44, 73%, had prepared business plans. Table 6 also shows that business owners with business plans might have sought bank financing in larger numbers than did business owners without business plans. Forty-four out of 178 business owners with business plans sought and received bank financing. This is 25%. The corresponding numbers for business owners without business plans are 16 out of 172, or 9%. There is, therefore, a possibility that the relatively low volume of bank loans that go to business owners without business plans also reflects the fact that relatively fewer business owners without business plans seek bank loans. We shall see in the next section that the leading reason cited for not preparing business plans by business owners without business plans was that they did not need to borrow money from banks. That bank lenders somehow encourage or force prospective borrowers to prepare business plans, as has been frequently suggested (Van Auken & Neeley, 2000; Mazzarol, 2001; Kaplan & Warren, 2007) appears to be borne out in this study. In Table 6 we see that while 73% of the business owners who got bank loans prepared business plans, only 47% of the business owners financed by family and friends prepared business plans. It would appear that it is relatively hard to get a business bank loan without a business plan.

Table 6: Business Plans and External Financing

Business Owners With	Types of External Financing				
	Bank Business Loans	Bank Equity Loans	Bank and Family Loans	Family and Friends Loans	Total
Business Plan	44 (73%)*	13 (61%)	26 (68%)	33 (47%)**	116
No Business Plan	16 (27%)*	8 (39%)	12 (32%)	37 (53%)**	73
Total	60 (100%)	21 (100%)	38 (100%)	70(100%)	189

*Business owners with business plans were more than twice as likely to get business loans as those without business plans, partly because they were more inclined to apply for bank loans than business owners without business plans.
** Loans from family and friends don't normally require business plans, but nearly 50% of those who got such loans had prepared business plans.

In our sample, 16 business owners had received bank loans without business plans. In fact one study on small business loans (Van Auken & Horton, 1996) found that banks required business plans only 49% of the time (although this percentage rose drastically in the case of minority business owners). The same study found that more important than business plans were collateral requirements, required 60% of the time.

The Value of Business Plans

The 178 business owners who had business plans were asked whether they had found business plans useful, and why or why not. One hundred and seventy, 96%, stated that they had found the business plans useful. Many reasons were offered. Providing direction was by far the most frequent reason given, nearly 65% of the time. For example, a children specialty store owner stated that "At times I have found it very helpful because it gives me something to follow and accomplish as a business owner." This reason for preparing business plans is often referred to as the "roadmap" function of business plans (Hatten, 2002; Ryan & Hiduki, 2006; Kaplan & Warren 2007). Keeping the business on track, a control function, was the second most frequent reason given by the business owners who found their business plans useful. Only 17, 10%, of business owners gave using the business plan as a tool for financing as the reason they found their business plans to have been useful. One would have expected this number to be higher since 44, 25%, of the 178 business owners with business plans had used the business plans to get bank loans. It appears that the interviewed business owners looked at the usefulness of business plans in longer terms, as opposed to using business plans for raising business funds, which often is a one-time deal. This study shows that the business owners who prepare business plans use them and value them for more than raising funds. Indeed, Table 6 shows that nearly 46 business owners prepared business plans even though they didn't have to, since their external financing came from equity loans and family/friends.

Only 5 of the 178 business owners with business plans indicated that they hadn't found their business plans useful. One business owner found the business plan not useful because he hadn't been able to use it beyond getting a bank loan. Another business owner found the business plan of not much value because the bank denied him a loan for his business even when he submitted the business plan. These kinds of business plan pitfalls generally arise from-single-purpose-use business plans (Zimmerer & Scarborough, 1996).

Reasons For Skipping The Business Plan

Business owners who started out without business plans were asked why they hadn't prepared business plans. As expected, a large number of reasons were given for not writing business plans. However, these reasons fall into three categories: there was no need to prepare a business plan, preparing a business plan was inconvenient, and lack of knowledge about business plans and/or the skills to prepare them. That the business plan was not needed was by far the dominant category, cited by 101, 62%, of the 162 of the business owners who explained why they hadn't prepared business plans. And this reasoning took three forms: the business owner was not using bank debt financing, the business owner was so experienced in the line of business he/she was going into that there was no need for a business plan and the business owner's business was too simple and small to warrant a business plan.

It was clear from the interviews that business plans continue to be seen as essentially or exclusively tools for raising business funds, implying that there was no need for a business plan if the start-up entrepreneur wasn't seeking external financing. We stated earlier that this view is shared by some authors (Kaplan & Warren, 2007).

A second reason why some business owners felt that the business plan was not needed is being already knowledgeable about and/or experienced in the line of business a business owner was planning to enter. This reason was commonly given by people with family business backgrounds. By incorporating market analysis, business planning forces would-be entrepreneurs to learn more about an industry or a business. So, industry/business knowledge and experience (or expertise) can be and was often seen as a substitute for preparing business plans by the business owners who were interviewed in this study. However, as can be seen from Table 7, lack of knowledge and experience in the industry or business was clearly not a particularly strong determinant of preparing business plans, since 109, 50%, of 219 business owners with industry experience prepared business plans. This was the exact percentage of "inexperienced" business owners who didn't prepare business plans. That is, business owners starting out with industry/business experience were no more inclined to prepare business plans than their counterparts without industry/business experience.

Table 7: Business Plans and Industry/Business Experience

Business Owners With	Sources of Industry/Business Experience				
	Employment	Education	Hobbies	No Experience	Total
Business Plan	109 (50%)*	13 (57%)	14 (%)	32(50%)	168
No Business Plan	110 (50%)*	10 (43%)	14 (50%)	33(50%)	167
Total	219 (100%)	23 (100%)	28 (28%)	65 (100%)	335

* 50% of owners with experience wrote business plans, 50% didn't. The same split is seen among business owners without experience.
Experience and business plans appear to be totally independent of each other.

A third reason business plans were considered unnecessary by the business owners who were interviewed was that their business concepts were too simple and/or their businesses were going to be too small to warrant the preparation of business plans. For example, a tee shirt business owner claimed that he didn't need a business plan because all he did was getting shirts, putting on logos and pressing. Several authors have suggested that the complexity of the business concept influences the extent of business planning (Mazzarol, 2001; Perry, 2001; Gibson & Cassar, 2002)

Thirty-four, 21%, of the 162 business owners who provided reasons why they hadn't prepared business plans when starting out claimed that preparing business plans created a variety of inconveniences. They cited the time it takes to prepare a business plan and the potential for business plans to prevent the business owner from changing direction when there is need to change direction. Sometimes business opportunities are time-sensitive and acting fast is very important. Many a business owner claimed having looked up some information about the business opportunity, but not finding the time to put that information in a written business plan. The lack of time and the fear that a written business plan would/could stand in the way for change often results in undocumented pre-start-up activities (Van Auken, 2000; Wally "Famous" Amos, 1999).

Twenty-seven, 17%, of the 162 business owners who provided reasons for skipping the business plans pointed to their lack of knowledge about business plans, what they are and/or how to prepare them. For example, one luncheonette owner told the interviewer that he had never heard about business plans because he never went to college.

CONCLUSIONS

That many new small business owners don't prepare formal business plans for launching their ventures was easily borne out in this study, as it has often been assumed, but rarely proved. In this study, 50% percent of the interviewed business owners stated that they had prepared business plans. The most important distinction about the business owners who had prepared business plans is that they used external financing, especially bank loans. The study found that providers of bank loans somehow encourage or force start-up entrepreneurs to prepare business plans. This finding is similar to that of Van Auken & Neeley (2000). Although banks sometimes provide business loans without requiring business plans from borrowers (Van Auken & Horton, 1994), they would rather lend to borrowers with documented pre-launch preparations. It is well known that most start-up entrepreneurs rely more on personal savings and loans from family and friends than on bank loans (Gwendron, 2004; Van Auken & Neeley 2000). If start-up entrepreneurs rely on loans from family by choice, which is highly doubtful, they might disregard written business plans. If entrepreneurs want to reduce their dependence on loans from family and friends, they would need a written business plan in most cases. In other words, business plans don't lose value and their place in business curricula because most start-up entrepreneurs rely on personal savings and friends, as has sometimes been suggested (Gwendron, 2007).

The study found that business owners seeking external financing were more inclined to write business plans than business owners who didn't target external financing. It was also found that the large majority of business loans went to business owners with business plans. However, business owners who prepared business plans valued their business plans more for providing direction, a roadmap function, than for raising business plans. This would mean that start-up entrepreneurs should write business plans even when they don't need external financing.

The study found that only a rare person would venture into a new business without any kind of planning. But most start-up entrepreneurs stop short of formal/written business plans. The study found three major reasons for not writing business plans: there is no need to write business plans, business plans inconvenience the start-up entrepreneur, and business plans require both knowledge and skill to write them. By far the most frequent reason cited for skipping the business plan was the belief that they were not needed. Start-up entrepreneurs who didn't need external financing overwhelmingly felt no need to write business plans, thus ignoring other purposes to which business plans can be put. We have noted already that the business owners who prepared business plans valued them more as tools for providing direction to operate the business than as tools for raising business funds. Business advisors and educators need to stress the multiple purposes of business plans.

A significant number of business owners who hadn't prepared business plans stated that their industry/business knowledge and experience rendered business plans unnecessary. While industry experience and knowledge was viewed as duplicating certain business plan activities, especially market analysis, 50% of the business owners with industry experience did in fact prepare business plans. It seems that the choice to rely more on experience than on written business plans, where market conditions are objectively evaluated, is reflective of a propensity for intuitive planning. Mazzarol stated that intuitive planning and formal planning are opposite mindsets (2001). Intuitive planning may also be the behavioral orientation of those business owners who stated that preparing business plans is inconvenient because it takes too long and prevents the entrepreneur from changing direction when he or she needs to. Intuitive decision makers don't need as much objective information as analytical decision makers. This is what Bangs calls "the man of action problem" (1993). It is known that expertise improves intuitive awareness (Dane & Pratt 2007). Intuitive planners don't write business plans under normal circumstances. They need a lot of encouragement, or even pressure to write business plans. Such pressure comes if and when their businesses grow and the owners have to deal with multiple and complex stakeholders such as accountants and wholesalers (Gibson & Cassar (2002).

STUDY LIMITATIONS

The conclusions in this study are very tentative, mostly because of the nature of the sample; a convenience sample . The 355 business owners interviewed were those who were convenient to interview by senior undergraduate students. There is also a possibility that students preferred to interview business owners who appeared to them to be "good" business owners. Accordingly, they wanted to learn something about them and their businesses.

Second, undergraduate students, seniors albeit, conducted the interviews. They were not trained interviewers. Although they were given a lot of background information about conducting interviews, there is no way of knowing that they avoided interviewer bias, such as the "first impression error".

Additionally, this paper, as many other efforts to understand entrepreneurs and entrepreneurship, is based upon self reporting: the business owners themselves stated what they had done before they opened up for business, sometimes as long ago as ten years. This is a limitation, although it has been said that starting a business is such a benchmark event that entrepreneurs generally accurately recall the details that surround it (Van Auken & Neely, 2000).

Finally, the study is very regional. New Jersey is densely populated and well served by many kinds of small business promotion programs. For example, there is a SCORE office at every county community college. It is possible that most of the interviewed start-up entrepreneurs had been exposed to some type of small business promotion program. Some of the conclusions in this study may not be valid for a more rural setting. This study should be done on wider scale.

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STRATEGIC PLANNING: A PRACTICAL PRIMER FOR THE ENTREPRENEUR

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ABSTRACT

Entrepreneurs are known for opportunity recognition. However, once a commercial entity is formed to take advantage of an opportunity, the leadership priority shifts from entrepreneurial to strategic. A strategic perspective leverages limited resources to position a business for future success relative to rivals in a competitive environment. Oftentimes, the talents needed for one priority are counter to those of the other.

This article intends to simplify one's transition from entrepreneurial to strategic. It walks an entrepreneur through the strategic management planning process using a fictional business. The various tasks in the process (mission, vision, internal analysis, external analysis) are illustrated with examples from a typical restaurant. The examples show how the strategic management tasks are interrelated and ultimately lead to a philosophical approach to managing a business.

INTRODUCTION

Entrepreneurs are primarily concerned with recognizing opportunities and seizing the initiative (Baron & Ensley, 2006). However, once seized, the organization needs to be able to survive in a competitive environment. For this follow-on survival, one needs strategic management skills in addition to the entrepreneurial skills already held (Ireland, 2007).

Strategic planning is beneficial to the small business. Studies show that it is strongly related to small business financial success (Katz & Green, 2007; Wheelen and Hunger, 2004). For example, Schwenk and Shrader (1993) applied meta analysis to the result of previous studies on formal strategic planning and the performance of small firms. The researchers found that even though the size of the effects of strategic planning for specific studies is not that large, the overall relationship between formal planning and performance is significant and positive.

Rue and Ibrahim (1998) found that greater planning sophistication is positively related to growth in sales though there was no significant relationship between planning and return on investment. Last, a study by Baker, Lon and Davis (1993) of high growth INC firms showed that 86% conducted strategic planning. Some 94% of these reported an improvement in profits. Ibrahim, Angelidis & Parsa (2008) showed similar results in small, family-owned businesses. In this article we intend to provide entrepreneurs a practical primer to strategic management in a very easy to understand format by following the process using a fictional restaurant in an urban environment.

PURPOSE

Entrepreneurs pour their hearts and souls into new ventures for years until they finally start to pay off (Mitchell et al., 2002). Perhaps they have heard of strategic planning but haven't really had time to pursue it as a process. The problem is that few know much about strategic management and have fewer still have ever participated in the process. And, unlike in larger organizations that may have strategic management departments, the onus for everything in smaller, start-up organizations, falls to the owner/manager.

Therein lay the purpose of this article—to remove some of the mystery associated with strategic management and to provide practical guidance towards taking the next step in managing an on-going business. A summary of the strategic planning process and a list of suggestions for conducting the process are provided. We think you will find that the process is pretty much common sense and easier to accomplish than originally thought.

The importance of strategic management to a business can be summed up with the old saying—"If you don't know where you are going, any road will take you there". Prudent use of the information contained in this article will help ensure that you and your company will find the road to success and will continue to follow it year-after-year.

THE STRATEGIC MANAGEMENT PROCESS

Your first step in learning the strategic management process should be to put yourself at ease. Although, the name itself invokes a grandiose scheme that may seem bigger than life, strategic management is, in fact, little more than an exercise in time management. It's all about how to achieve what's important when faced with conflicting demands and limited resources. Second, don't get caught up in the hype of strategic management. Too many organizations go through the motions but lose sight of the intent. These companies are ridiculed in mainstream culture such as in the Dilbert comic strip. Remember the intent of strategic management is to set your company up for future success.

The following discussion includes descriptive steps in the strategic planning process. The first phase of strategic management is planning followed by implementation. We concentrate on the planning process here by showing how things *should* progress while giving some practical examples.

Mission

This is your starting point. Equally important as knowing where you are going, you need to know where you are starting from—where you are today (Collins & Porras, 1996). A good mission statement would include your company's name, its major product/service offering, its major customer(s), and its source of competitive advantage. It needs to answer the question of "Why are we in business?"

For illustration, assume a fictitious restaurant, Mama's. Mama's provides lunch service in an urban downtown setting. A good mission statement would be:

"Mama's restaurant provides workers in the central business district a home-cooked lunch. Our success rests on our unique, relaxed, home-style atmosphere where you can "get away" from the work environment, if just for a moment".

After reading this mission, one can easily picture what the business does. It would be difficult to develop a similar understanding if the mission was simply "To make money". In a capitalistic economy, it's a goal of most businesses to make money. The issue at hand is to structure and position your company so that it has the best opportunity to make more money than the competitors.

Vision

We can all remember President John F. Kennedy's vision of "A man on the moon by the end of the decade" and Martin Luther King's vision of "I have a Dream". Both are simple yet extremely powerful.

A good vision need not be as powerful as those above; but, it should be useful. The business's vision should paint a clear picture of the company in the distant—one that can easily be seen in the mind. In general, Vision development should be easy for an entrepreneur. After all, the vision is simply a representation of the opportunity which was recognized and led to the formation of the business in the first place.

In general a vision is often less defined than the mission and more goal-oriented. Visions provide a unifying motivation. While flexible, three to five years is a reasonable time frame. A good vision should inspire and motivate the entire company. Building on Mama's example, a decent vision could be, "When the harried workers think of lunch, Mama's is the first choice that comes to mind". This vision provides sufficient direction for managers at Mama's to use when setting priorities.

Now that we know where we are (e.g., the mission) and where we want to go (e.g., the vision), it's time for a reality check. The owner/manager needs to evaluate his company relative to competitors to see what he need to do in order to make sure that he can reach his desired future. This issue is addressed in the next part of the process and has two steps. We start by looking inside the business with an internal evaluation of what the company has and then look outside at the external environment to see how the company compares to competitors.

Internal Evaluation

Internal evaluation involves some serious soul-searching. You need to look around and take inventory of everything that you have at your disposal. Put yourself in Mama's shoes and the inventory should contain everything: people, buildings, desks, chairs, chicken roasters, refrigerators, freezers, etc.—these are resources. Now look at what you're doing with those resources: preparing meals, serving meals, cleaning up after meals—these are activities.

The internal evaluation process should provide a very detailed description of the business, what it has and what it does. The more detail the better. In fact, the soul-searching session will be more effective if you can remain objective and refrain from assigning adjectives during the identification phase. To illustrate by building on Mama's example, one resource could be the restaurant's address/location. While the location may be a reason for success, avoid any claims of 'prime' location for the moment. Simply list everything; the list will be pared down and prioritized later.

Mama's resources would include: a chef with credentials from a particular culinary institute; two hostesses; five wait staff; 1,000 square feet seating area with thirty tables; a lease on the property; a kitchen capable of producing fifty meals per hour; etc. Mama's activities would include: receiving the ingredients to the meals; preparing the meals; serving the meals; cleaning up after the meals; greeting incoming diners; seating the diners; taking orders; delivering the meals; disposing of the waste; paying the employees; developing menus; etc.

The more detail is better because we have to evaluate each of these activities to see where we rank relative to competitors. We want to find out what Mama's does better than her competitors. Furthermore, why should potential diners choose Mama's over her competitors: Papa's, Uncle Joe's or Aunt Jane's? This is the question we want to answer next, and the more activities we have in our description, the more options we have in our next step—external evaluation.

External Evaluation

It is important research the trends in the industry in which you are operating. In Mama's case, restaurant industry trends which may impact her restaurant include eating habits, technology, regulations at all levels of government and a rise in the cost of doing business, e.g., labor, utilities, insurance, and supplies. Information about the restaurant industry may be obtained from the National Restaurant Association or a state restaurant association.

The local economy and trends need to be considered by all small businesses in the area. Mama needs to study changes in population, demographics, consumer lifestyles, and economic development factors. An assessment of the local economy and population changes in population may be procured from the local economic development agency for her city, county, etc. or the business research unit located in a nearby university. Trade newspapers, attending area Chamber of

Commerce meetings, and in Mama's case, attending area restaurant association meetings could be most informative.

You now need to identify your Industry; this is you and all the competitors fighting for the same group of customers (Porter, 2008). Your company's intent should be to attract those customers instead of allowing them to freely seek out your competitors; this is critical to your company's success. Simply, you need to determine what the customers want. You then need to perform those internal activities which are the bases for what the customers want; and, you need to do so better than the competitors.

Of course, this is much easier said than done. You'll have to rely on marketing research to identify what your target customers want and how they decide among various competitors. In Mama's target market, the potential diners come from occupants of the office buildings in the central business district; this is consistent with her mission statement. Mama hired a consultant to survey the potential customers to see what criteria they use when deciding where to eat lunch. The consultant identified three factors: within three blocks walking distance; a relaxed atmosphere; and, good tasting food. Mama, being familiar with the area around her restaurant, identified three other restaurants that may be able to satisfy the above criteria: Papa's, Uncle Joe's and Aunt Jane's.

The task at hand is to make sure that Mama's is better able to provide the above three factors better than the other three restaurants can. In other words, Mama wants to make sure she has a competitive advantage. Therefore, we need to evaluate each of Mama's activities relative to the corresponding activities of the other three competitors. The initial intent is to see which activities Mama's performs better (i.e., her strengths) and where Mama's doesn't perform as well (i.e., her weaknesses) relative to her competitors' performances.

We can now revisit Mama's activities and see if, and where, she has a competitive advantage. Recall, the customers' first decision criterion was convenience. After evaluating her location relative to those of the three competitors, we can see if more potential customers are within a three block radius or not. The second criterion was atmosphere. After hiring an objective evaluator to visit all four restaurants, Mama found that hers rated as the most relaxed. This evaluation demands further measure since it is so critical. She really needs to come up with objective measures for defining a 'relaxed atmosphere'. The third criterion was quality food. Again, an objective evaluator could be hired to taste the offerings. A simple proxy measure for food quality could be the credentials of Mama's chef relative to those of the chefs of the competitors.

Due to space constraints, we'll limit our coverage here. To be really useful, you should evaluate all of your activities against very specific measurement criteria in order to see where you rank relative to your competitors or industry standards (Barney, 1997). You may find other sources of competitive advantage as well as areas, not necessarily linked to the competitive advantage but where you need to improve your business such as reducing costs.

We'll now shift our focus to the longer term considerations. What else is going on around your company that you haven't considered yet? How will those events change the way you're conducting the business in the long term?

Other External Considerations

Consider the price of gas. Mama's is not immune to rising gas prices; it affects the cost of her ingredients. Mama is faced with two choices; she can raise her menu prices or simply absorb cost increases and not make as much profit. In Mama's marketing research report we should have noted that price was not one of the major decision criteria on the part of potential diners. Therefore, Mama could raise prices to compensate for increased costs without losing customers. Of course, there is some price level where the other criteria will start to play less of a role; this needs to be considered during the marketing research process.

In general, we refer to external factors that can have a positive impact on businesses as opportunities and the negative ones as threats. Since these opportunities and threats affect all businesses, your company's specific competitive advantage will allow you to benefit more than your competitors when all are faced with the same opportunity.

For instance, the increase in corporate downsizings has increased stress and lowered the number of employees. On the positive side (from Mama's perspective), increased personal stress also increases the need for one to seek whatever relaxation one can find during the day. A restaurant that provides an oasis of relaxation will enjoy a correspondingly higher demand than those without such an atmosphere. On the negative side, the corporate downsizings have reduced the total population of potential diners. However, since Mama enjoys a higher demand than the competitors, she will most likely lose fewer customers than the other three.

The evaluation of the general environment is the least well defined in strategic management. One must be very creative and insightful in order to notice changes. In fact, it would really help if you could predict the future. However, since that's impossible, your next best bet is to stay alert to what's going on around you by scanning the environment. By paying close attention to as much media as you can afford, you become more sensitive to changes. Although you won't be able to actually predict a change, you may be able to notice subtle changes before your competitors. You can then take action before anyone else and give yourself a competitive edge.

Putting it all together in a Plan

It's now time to put these pieces together into a coherent and comprehensive strategic plan. The theme in any strategic plan is to fit all the pieces together. Ask yourself the following questions and then develop a to-do list of objectives that will set your company up for future success:

- *Do I have sufficient resources to accomplish my current mission and achieve my future vision?*
- *Do I have sufficient strengths to ensure that I remain competitive?*
- *Do I have too many weaknesses such that they will overwhelm any advantages I may have?*

- *Are there enough opportunities and not too many threats such that I can achieve my future vision?*

If you can answer all questions, yes, then your priority is to simply monitor the situation and note if anything changes. If you answer no to any of the questions, then you need to establish a detailed action list to correct the situation. Based on your understanding of where each of the pieces fit into the bigger picture, you can develop an action plan to correct the situation.

Developing a plan may be difficult for Mama's management due to the lack of time, unfamiliarity with strategic planning or planning skills (Wheelen & Hunger, 2004). An excellent source of free help is available from a nearby Small Business Development Center (SBDC). The nearest SBDC to Mama's may be found on the Internet.

Actually accomplishing the necessary tasks is the basis for the second phase of strategic management, the implementation phase. But, until the actions are identified, the plan can't be carried out. The entire process strategic management process becomes iterative and enduring. It's easy to see that strategic management is a philosophy or way of thinking.

SUMMARY

Strategic management is all about positioning your company relative to your competitors so that your performance will be better than theirs. This process is accomplished through discrete but interconnected steps where you identify resources and activities. You then compare your activities against your competitors' activities to see whose are better; these become strengths for the owner. Your strengths that correspond to what the customers want become your competitive advantage. You then use your competitive advantage, in the face of changing environmental conditions, to out-perform your competitors.

All too often we hear about: putting out the fires; crises management; and, reactive vs. proactive. We 'know' that we should plan; it's just too easy not to plan. Through the use of this primer, we hope that you how have a better understanding of the practical application of strategic management tools. Even more so, we hope that you recognize how naturally strategic management fits with a common sense perspective of running an on-going business. Finally, combining an understanding that one should plan with the planning structure that strategic management provides, we hope that many will embrace the strategic management philosophy and enjoy a positive influences on their bottom lines.

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A FINANCIAL FEASIBILITY TEST FOR ASPIRING ENTREPRENEURS

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ABSTRACT

While there are numerous reasons for small business failures, one of the most common is undercapitalization (Case, 1996; Gross, 1993). A contributing factor to this problem is the failure of many entrepreneurs to accurately estimate the minimum level of pre-tax income which the new business must generate in order to maintain their desired standard of living. As a result, they withdraw excessive funds which are not replenished by profits, often leading to further indebtedness and threatening the survival of the business. We have found that this problem can be minimized by performing a "financial feasibility test" with the aspiring entrepreneur, which converts the individual's family budget into the pre-tax income which the new business must generate in order to cover it. Different versions of this computation for different types of entities (sole proprietorships, partnerships, corporations, LLCs, etc.), along with examples, are presented and explained. In addition, alternative actions which may be taken depending upon the outcome are discussed. The major benefit of this process is that it provides the aspiring entrepreneur with a better understanding of the extent to which a new venture is likely to support the standard of living that they have in mind, and permits the business owner to respond proactively in order to reduce the risk of future financial difficulty.

INTRODUCTION

Hundreds of thousands of small businesses are created annually, yet it has been estimated that as many as 80% fail within the first five years (Nickels, et al., 1999). While there are many reasons for small business failures, including lack of experience, failure to properly price goods and services, and inadequate record keeping, one of the most common is undercapitalization (Case, 1996; Gross, 1993).

We have worked with many small business owners, both in our professional practices and through presentations at local Small Business Administration seminars. In the process, we have met many prospective entrepreneurs who have enthusiastically desired to leave the 'rat race' to start their own businesses. Some have become quite successful. However, those who fail for financial reasons typically experience the following chain of events.

First, the new entrepreneur discovers that it takes longer for the new business to generate profits and cash flow than expected. As a result, they are forced to cover any remaining operating expenses and their personal living expenses by taking cash from their initial investment, and any subsequent investments. Next, in order to obtain more working capital, the owner borrows additional funds in the form of a bank loan or line of credit, a second mortgage, loans from friends or relatives, or more credit cards. Finally, when it becomes clear that the business will not generate enough profits and cash flow to pay off its growing financial obligations, the owner shuts it down and pays off the creditors from other assets and/or declares bankruptcy.

In order to guard against this unwanted, yet all-too-common outcome, most entrepreneurs are advised (or required by loan officers) to demonstrate the financial feasibility of their business by preparing a business plan, complete with projected income and cash flow statements (Bostrom, 1999; Reierson, 1995). However, it has been our experience that while all entrepreneurs understand the importance of positive income and cash flow, they often underestimate the minimum levels which must be generated to maintain their desired standard of living.

Many reference guides stress the control of personal living expenses (U.S. Small Business Administration, 2009; Reierson, 1995; Whitmyer & Rasberry, 1994). However, we have found that few of them explicitly link personal living expenses to the pre-tax income which must be generated by the new business in order to cover them. The failure to make this connection explicit, and the subsequent withdrawal of excessive amounts of cash from the business by the owner in order to maintain a desired standard of living, is one of the most common reasons for working capital deficiencies and business failure.

THE FINANCIAL FEASIBILITY TEST

To minimize this problem, we have developed what we refer to as a “financial feasibility test” to help focus the new entrepreneur’s attention on this issue, and to help them decide whether they are truly ready to undertake self-employment. First, we require the entrepreneur to prepare a family budget. Then, we link it to the pre-tax profit which must be generated by the new business with the following computation:

$$\text{Pre-Tax Profit} = \frac{\text{Family Budget} - \text{Other Income}}{1.00 - \text{FIT \%} - \text{SLT \%} - .0765 - .9235\,(.0765)}$$

FIT % represents the entrepreneur’s effective federal income tax rate, and SLT % represents the entrepreneur’s effective state and local income tax rate (for states which which have a state and local income tax). The .0765 is the combined tax rate for Social Security and Medicare (FICA).

This computation focuses the owner's attention on the the cash flow which must be generated from the pre-tax profit of the new business, because withdrawals that cannot be replenished by profit in many cases lead to greater indebtedness, thereby threatening the survival of the business as noted above. (It should be noted that this computation is similar to those used by accountants to convert an employee's net pay to the corresponding gross pay amount. However, it is not identical and serves a different purpose: to focus the aspiring entrepreneur's attention on the pre-tax profit necessary to support their desired standard of living.) When the financial projections for the business are prepared, they can be compared to the results of the above computation to determine whether the projected pre-tax profit achieves this objective.

Below is an example. Assume that an aspiring sole proprietor has determined, from preparing a family budget, that \$5,000 a month is required to maintain a desired standard of living. Also assume that this individual receives \$2,000 a month in other income from investments, a pension, part-time employment, etc. His/her effective federal income tax rate net of all exemptions, itemized deductions, etc. is 20%, and his/her effective combined state and local income tax rate is 5%. All self-employment income or employment income is subject to both the employee's and the employer's share of the 7.65% FICA tax. Multiplying the employer's share by .9235 in the above computation takes into account the tax deductibility of the employer's share paid by a sole proprietor. Inserting these amounts produces the following result:

$$\text{Pre-Tax Profit} = \frac{\$5{,}000 - \$2{,}000}{1.00 - .20 - .05 - .0765 - .9235\,(.0765)} = \frac{\$3{,}000}{.6029} = \$4{,}976$$

Thus, the aspiring sole proprietor's new business will have to generate \$4,976 of pre-tax profit per month in order to provide a monthly draw of \$3,000 which will maintain his/her desired standard of living. This computation can also be used to determine a partner's necessary share of partnership income, and the necessary pre-tax income for the member(s) of a limited liability company taxed in a similar manner.

For other types of entities, the computation and/or its interpretation will vary slightly due to the differences in how profits are withdrawn. For a C or an S Corporation in which all of the profits are paid out as salary and bonus, Pre-Tax Profit represents the pre-tax profit which must be available for salary and bonus in order to maintain the desired standard of living. If, however, any portion of the Pre-Tax Profit will be extracted as dividends (C Corporation) or as draws (S Corporation) due to tax planning or cash flow concerns, the above computation should be split into two parts. The first part would represent the portion of Pre-Tax Profit necessary to maintain the entrepreneur's desired standard of living to be covered by salary and bonus. The second part would represent the portion be covered by dividends or draws. The details of this two-part computation, along with an example, are shown in the Endnote below.

DISCUSSION

If the aspiring entrepreneur discovers that the pre-tax profit required to cover his/her family budget does not exceed the amount indicated by the projected financial statements, he/she can proceed with greater confidence that the new business is likely to be successful if the family budget is followed. If the opposite outcome is obtained, however, several courses of action can then be considered (Bostrom, 1999; Whitmyer & Rasberry, 1994). First, the individual may revise his/her business plan in an effort to achieve a greater level of income. Second, if a significant increase in profit and cash flow can be projected over a longer time frame, the entrepreneur may be willing to incur greater debt over the short term in expectation of future repayment. Third, the entrepreneur may seek an additional source of income, such as maintaining his/her current employment on a part-time basis. Finally, the entrepreneur may be willing to reduce his/her personal living expenses (perhaps in exchange for the nonmonetary rewards of being self-employed), or he/she may decide to postpone or abandon the new venture.

We have found that the primary benefit of requiring a prospective entrepreneur to prepare a family budget, followed by performing the above Pre-Tax Profit computation, is that the individual will obtain a better understanding of the extent to which the new venture can support the standard of living that they have in mind. If the results are favorable and the entrepreneur decides to go forward, he/she will have an awareness of the maximum personal living expenses which can be covered by projected pre-tax profits, thereby reducing the risk of substantial (and potentially fatal) increases in indebtedness. If the financial projections for the new business do not indicate a sufficient pre-tax profit, the entrepreneur may proactively take one or more of the actions noted in the previous paragraph, thereby reducing the risk of future financial difficulty. Or, he/she may decide to postpone or abandon the proposed venture, thereby avoiding a costly mistake and preserving resources for a better opportunity in the future.

ENDNOTE

The Pre-Tax Profit computation for a C Corporation should be split into two parts when a portion will be extracted as dividends, as follows:

$$\text{Pre-Tax Profit} = \frac{(\text{Family Budget} - \text{Other Income}) * \text{Payroll \%}}{1.00 - \text{FIT \%} - \text{SLT \%} - .0765 - .9235\,(.0765)} +$$

$$\left(\frac{(\text{Family Budget} - \text{Other Income}) * \text{Dividend \%}}{1.00 - \text{FIT \%} - \text{SLT \%}}\right) \Big/ 1.00 - \text{CIT \%}$$

FIT % represents the entrepreneur's effective federal income tax rate, SLT % represents the entrepreneur's effective state and local income tax rate (for states which which have a state and local income tax), and CIT % represents the corporate income tax rate. The .0765 is the combined tax rate for Social Security and Medicare (FICA).

The first part represents the portion of Pre-Tax Profit necessary to maintain the entrepreneur's desired standard of living to be covered by salary and bonus, as described earlier. The second part represents the portion to be covered by dividends. The FICA percentages are removed from the denominator of the second computation since dividends are not subject to FICA taxes. The second part is also divided by 100% minus the corporate tax rate in order to convert it to the equivalent pre-tax amount. The sum of these two parts represents the total pre-tax profit necessary to support the entrepreneur's family budget.

For example, assume that an aspiring entrepreneur who has created a C Corporation has decided, due to tax planning or cash flow concerns, to withdraw 80% of his/her pre-tax profit as salary and the remaining 20% as dividends. Assuming the same family budget, other income and tax rates as the previous example and a corporate income tax rate of 15%, the Pre-Tax Profit computation is:

$$\text{Pre-Tax Profit} = \frac{(\$5{,}000 - \$2{,}000) * .80}{1.00 - .20 - .05 - .0765 - .9235\,(.0765)} + \frac{(\$5{,}000 - \$2{,}000) * .20}{1.00 - .20 - .05} \Big/ 1.00 - .15$$

$$= \frac{\$2{,}400}{.6029} + \frac{\$600}{.75} \Big/ .85 = \$4{,}922$$

For an S Corporation, the second part of the above computation would represent the profit which must be available for draws. Since the profits of an S corporation are not subject to income taxes, this amount does not have to be divided by 100% minus the corporate tax rate, and may be added unchanged to the first part of the computation for salary and bonus to determine the total pre-tax profit necessary to support the entrepreneur's family budget. (A separate computation would also be have to be performed for a required monthly salary in excess of $8,900 for 2009, since any amount in excess of $8,900 would not be subject to Social Security taxes.)

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ENTREPRENEUR BEWARE

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ABSTRACT

The risks associated with entrepreneurship have been well documented. It is widely understood that the majority of newly formed small businesses will eventually fail within the first seven years. What is not well documented, however, is that many of these entrepreneurs seek to reorganize their debt by filing for Chapter 7 bankruptcy. Small Businesses account for eighty-five percent of all Chapter 11 bankruptcy filing. While most Chapter 11 filings are entered into by small business entrepreneurs, most are involuntarily converted to Chapter 7 cases, resulting in the liquidation and termination of the business. In 2005, a revised version of the bankruptcy code was enacted, significantly augmenting the small business reporting provisions, and increasing the grounds in which a Chapter 11 filing can be converted into a Chapter 7 liquidation. In order to survive a Chapter 11 filing, the entrepreneur should observe the four critical success factors.

INTRODUCTION

Entrepreneurship has been a cornerstone of our economy, accounting for over half of all jobs within the United States, and approximately forty-eight percent of the private GDP. With a monthly average of over half a million newly created businesses, small-businesses employ more than half of the American labor force and generate two thirds of the net new jobs in America (Efrat, 2008). Moreover, small-business owners make up 6 percent of the adults population and approximately 11 percent of working Americans. (Efrat, 2008). In order to start a small business, the entrepreneur must invest not only an initial infusion of capital, but also scarce resources such as human capital and time.

While entrepreneurial activity accounts for two thirds of all new jobs, and approximately half of the private GDP, the survival rate of small businesses are dismal. Approximately one third of new businesses fail within two years of operation (U.S. Business Administration, Office of Advocacy, 2003). Moreover, half of all new businesses fail within five years of operation. When a business fails, there are two types of liability that the entrepreneur must consider (U.S. Business Administration, Office of Advocacy, 2003). The first type of liability is the scope of the entrepreneur's personal liability for the remaining debts of the business. In order to calculate the owner's personal liability for the debts of the business, the entrepreneur must first determine the form of business structure under which the business was organized (Winrow, 2007). If the entrepreneur was formed as a general partnership or as a sole proprietorship, the entrepreneur will be liable for all existing liabilities in excess of the businesses assets. In other words, once the business is liquidated, the entrepreneur must personally satisfy any remaining debts that exceeded the businesses assets (Winrow, 2007). If, however, the business was formed as a business structure containing the limited liability attribute, the entrepreneur will be shielded from personal liability as the limited liability attribute severs liability at the level of the business. While the limited liability attribute usually shields the entrepreneur from personal liability, the entrepreneur will still incur liability if she personally guaranteed a debt, or signed in her personal capacity, at the time the debt was entered into (Geu, 1992). When this occurs, the entrepreneur is personally guaranteeing the payment of said debt. This has become a common scenario, as many lending institutions and investors have become hesitant to invest in new limited liability business structures, due to the low success rate.

The second component of liability occurs when a business encounters financial difficulties, but wants to continue the business in lieu of liquidation. When an entrepreneur encounters financial challenges, and is unable to pay creditors, she may seek bankruptcy protection, which results in an automatic stay. This stay prohibits creditors from contacting the debtor for a proscribed duration of time. When encountering severe financial distress, the entrepreneur may either seek judicial protection by filing for chapter 7, or chapter 11 bankruptcy (there are other chapters, but 7 and 11 are most frequent filing for entrepreneurs). The corollary under Chapter 7 is divergent from Chapter 11. Under Chapter 7, the entrepreneur is seeking the discharge of the entity's existing financial obligations. In order to achieve this result, the businesses assets are liquidated and apportioned between the creditors, according to their level of priority as determined by whether they are classified as an unsecured, secured or perfected creditor. After the bankruptcy is completed, the entrepreneur is relieved of her financial obligations, unless she signed in her personal capacity. The end result is the termination of the business venture.

While Chapter 7 serves to terminate the business, many entrepreneurs, true to their character, are adamant about continuing the venture, while seeking a temporary stay of relief from creditors. In order to facilitate this objective, the entrepreneur can file for Chapter 11 bankruptcy protection. Under Chapter 11, the entrepreneur seeks to reorganize the organizations debts by negotiating with creditors (Efrat, 2008). The aim is to renegotiate the structure and terms of the debt, in order to reemerge from bankruptcy as a viable and sustainable entity. According to the National Bankruptcy Review Commission, small businesses make up at least eighty-five percent of all Chapter 11 filings (Morrison, 2007). As a result, it is imperative that entrepreneurs are cognizant of the existing Chapter 11 provisions pertaining to the small business.

In 2005, the bankruptcy code underwent an extensive revision, whereby many of the procedures concerning small businesses were augmented (Morrison, 2007). The legislative intent of the revisions was designed to thwart drawn out Chapter 11 filings whereby the entrepreneur/debtor seeks to extend the temporary stay while still operating the business (Morrison, 2007). While this was the premise in which the 2005 revisions were based, the evidence pertaining to the duration of small business filings do not support the burdensome revisions. According to a recent study, it was discovered that sixty percent of small businesses seeking Chapter 11 protection were converted to Chapter 7 proceedings, leading to the liquidation of the business (Morrison, 2007). Of the businesses that were impelled to Chapter 7, fifty percent were converted within three months of the original Chapter 11 filing (Morrison, 2007). In addition, seventy percent were converted within five months of the original filing (Morrison, 2007). Finally, it was discovered that ninety-one percent of the small businesses that were liquidated after seeking Chapter 11 protection were liquidated within one year (Lawless, 2007). The timeframe in which reclassification occurred is significantly less than twenty-one months, which is the median time it took for satisfactory completion of a Chapter 11 reorganization (Lawless, 2007). Based upon these statistics, the average time under which a business sought Chapter 11 protection, and was subsequently liquidated, was no longer in duration than other contending chapters (Morrison, 2007). With the 2005 revisions, the challenges confronting the small businesses plight through Chapter 11 has been magnified.

ANALYSIS OF THE 2005 BANKRUPTCY REVISION

The 2005 revisions were exceedingly problematic for small businesses. There were 17 sections devoted to addressing small businesses (Lawless, 2007). When comparing and contrasting the pre 2005 legislation with the 2005 revisions, it becomes evident that the restraints on small businesses were tightened. There are three fundamental changes in the 2005 revision that will severely inhibit the ability of entrepreneurs to reorganize their debts and emerge from bankruptcy as a viable business (Lawless, 2007). The three provisions are comprised of mandatory small business classification, enhanced reporting requirements, and an expansive list of enumerated factors under which a court can reclassify a Chapter 11 filing to Chapter 7 liquidation (Lawless, 2007).

Small Business Defined

The 2005 revision foreclosed on the voluntary election for filing as a small business whereby the entrepreneur could select whether to be subject to the small business provisions, in lieu of mandatory filing (Lawless, 2007). Under the revision, there is a two prong test to ascertain whether a business falls under the purview of the small business requirements, and would then be subject to the heightened regulations. The first component of the test inquires into whether the entrepreneur is engaged in commercial or business activity. The issue as to what constitutes commercial or business activity is ambiguous, as the revision does not provide a definition. The definition appears to be inclusive, not requiring substantial business activity. As a result, a plausible argument can be made that a sole proprietor earning money be mowing a yard would be classified as a small business (Lawless, 2007).

The second prong of the test is centered on the businesses total debt. The focus on debt as the measure of a small business disregards the traditional barometers which are usually comprised of annual sales or the number of employees. Under the second prong, any business meeting criteria one, and has under $2,000,000 in liquidated secured or unsecured debt are classified as small businesses (Lawless, 2007). Once classified as a small business, it is mandatory that the entrepreneur comply with all provisions designed for the small business. The following sections will focus on the reporting requirements pertaining to small business, with an emphasis on contrasting the pre and post 2005 bankruptcy laws, most of which are contained in sections 308 and 1116 (Lawless, 2007).

Enhanced Reporting Requirements

Reporting is a bedrock principle of bankruptcy. It is necessary in order to prevent practitioners from frivolously filing for Chapter 11 bankruptcy as a procedural strategic advantage by seeking the legal safeguards associated with the stay of creditors, in order to gratuitously renegotiate more favorable terms. While reporting requirements are desirable to prevent abuse of the system, the reporting safeguards were amplified in the 2005 revision, and are not evenhandedly applied between small and large businesses.

Under section 308, the Advisory Committee on Bankruptcy Rules has fashioned Form 25C, Small Business Monthly Operating Report, which contains the new reporting requirements for small businesses (Lawless, 2007). The entrepreneur is compelled to complete and file form 25C on a monthly basis. The form is segmented into several categorical questions comprised of operations; taxes; income; expenses; cash profits; accounts receivable; accounts payable; banking information; number of employees; professional expenses; and the next months pro forma statements (Advisory Committee on Bankruptcy Rules, 2006). The form concludes with a request that the entrepreneur compare the next month's projections to the actual performance of the business during the first 180 of bankruptcy (Advisory Committee on Bankruptcy Rules, 2006).

The comprehensive reporting requirements contained within Form 25C is designed to provide both the court and the creditors with an intimate understanding of the financial condition of the small business. While Form 25C accomplished the objective, it often imposes a hardship on small businesses. While the entrepreneur must comply with rigid monthly reporting requirements, large publicly traded corporations in bankruptcy can be excused from their quarterly filing reports that corporations outside of bankruptcy must file (Lawless, 2007). Such discrepancy is counterintuitive as the larger corporations will have debt in excess of $2,000,000 versus small businesses that are limited to businesses with under $2,000,000 in debt (Lawless, 2007). Such heighted reporting requirements for small businesses can have detrimental effects to the entrepreneur, as it increases the opportunity for creditors to claim the entrepreneur mischaracterized its dealings (Lawless, 2007).

Serial Filer Provision

The second distinction relates to the serial filer provisions which, in some situations, can rebuff the automatic stay provision. The most common instance occurs when the entrepreneur has filed a previous bankruptcy within the immediately preceding two year period, or when a small business acquires the assets of another business that has filed for bankruptcy within the same two year period (Lawless, 2007). The serial filer provisions are confined to small businesses and are inapplicable to large businesses. This disparity illustrates the disproportionate restrictions that entrepreneurs face when seeking Chapter 11 bankruptcy protection.

Grounds For Dismissal

The third significant alteration is the expansive inclusion of proscribed factors, based upon cause, resulting in the dismissal or conversion of small business Chapter 11 filings. There are sixteen proscribed grounds which constitute case (11 U.S.C.A., 2006). This includes (1) substantial or continuing loss of the estate and the absence of a reasonable likelihood of rehabilitation;(2) gross mismanagement of the business; (3) failure to maintain appropriate insurance: (4) unauthorized use of cash collateral substantially harmful to one or more creditors; (5) failure to comply with a court order; (6) unexcused failure to comply with the reporting requirements as previously described; (7) failure to attend the meeting of creditors without good cause shown by the debtor; (8) failure to timely provide information or attend meetings reasonably requested by the United States trustee; (9) failure to timely pay taxes owed after the date of the order for relief or to file tax returns due after the date of the order for relief; (10) failure to file a disclosure statement within the allotted time fixed by this title or by order of the court; (11) failure to pay any required fees or charges; (12) revocation of an order of confirmation under section 1144; (13) inability to effectuate substantial consummation of a confirmed plan; (14) material default by the debtor with regard to a confirmed plan; (15) termination of a confirmed plan by reason of the occurrence of a condition specified in the plan; and (16) failure of the debtor to pay any domestic support obligation payable after the date of the filing of the petition (11 U.S.C.A., 2006). The code has two particular provisions fashioned to dismiss or concert a Chapter 11 filing based upon the failure to comply with reporting requirements. The first cause is based upon the failure to comply with the reporting requirements (11 U.S.C.A., 2006). Such an omission suffices as cause thus warranting the conversion or dismissal of a filing. The second cause pertains to the failure to file a disclosure statement as required under the code (11 U.S.C.A., 2006).

CRITICAL SUCCESS FACTORS

Most businesses that file for bankruptcy are classified under the bankruptcy code as small businesses. Moreover, the majority of these businesses that seek Chapter 11 protection are impelled to Chapter 7, whereby the business is liquidated, terminating the entrepreneurs venture. By initially filing for Chapter 11, the entrepreneur is signaling her will to emerge from bankruptcy as a sustainable viable entity. Unfortunately, the desire to emerge from Chapter 11 does not usually materialize. This section will discuss several procedural critical success factors the entrepreneur needs to abide by in order to emerge from Chapter 11.

Accountability

Under the 2005 code, small businesses have heightened reporting requirements in order to progress through Chapter 11. If the entrepreneur fails to comply with the reporting requirement, they can be reassigned to Chapter 7, which requires liquidation of the assets. These reports are comprehensive, requiring such information as projected financial statements, cash flow information, and comparisons to previous reporting requirements. In order to conform with the requirements, the entrepreneur should designate an employee or independent contractor to monitor and satisfy the monthly reporting requirements. While incurring additional costs associated with hiring another employee, or reassigning time to a current employee, may seem counterintuitive, it can shield the business from involuntarily being subject to liquidation. In either event, the new reporting requirements will require an investment in time and capital. Moreover, the entrepreneur should be spending a substantial amount of time analyze the current mission and strategy of the business.

Control Costs

While the reporting requirements are exceedingly onerous, key information can be derived from the detailed reports. This information should be used to reevaluate costs and procedures. Moreover, this should provide the entrepreneur with an intimate understanding of the cash flows of the business, as form 25C requests information pertaining to both accounts payable and accounts receivable. In addition, form 25C requires the entrepreneur to divulge information concerning the operations of the business. This opportunity affords the entrepreneur with an additional opportunity to focus on costs, in addition to reevaluating the businesses mission, goals, and objectives.

Re-engineer Business Model

When filing for Chapter 11 bankruptcy, the entrepreneur should take the opportunity to reevaluate its current mission, goals and objectives. This includes analyzing the source of the entity's predicament necessitating the courts protection. The issue could be as simple as mismanaging the business's cash flows or may be more complex such as failing to properly identify the business's target market. During this process, it is imperative that the entrepreneur focus on both short-term and long-term goals. The short term process is important for two reasons. First, the entrepreneur needs to enhance its financial position not only to emerge from bankruptcy, but to become a sustainable entity. Secondly, the court evaluates the required disclosures which encompass a comparison of the firms' performance during bankruptcy with prior disclosures. In order to increase sales, the entrepreneur must be cognizant of the factors initially causing financial distress, and then taking steps to remedy those shortcomings. In addition, the entrepreneur should review long-term objectives that will lead to developing and implementing a new strategic plan.

Strategic Management Review

When creating the business plan, the entrepreneur should have designed and implemented a creative strategy whereby she was able to capitalize upon her core capabilities to distinguish her business from the competition. The strategic management review process should incorporate the same in-depth analysis that the entrepreneur undertook when forming the business venture. This includes analyzing the target market, promotional mix, management and human resources plan, as well as ascertaining whether the entrepreneur should reposition its product within the marketplace and implement a different pricing strategy.

CONCLUSION

It is essential for the entrepreneur to understand the heightened laws they will be analyzed under should they seek bankruptcy protection. Most research associated with entrepreneurship liability is concentrated on the liability protections afforded to the entrepreneurs, shielding them from incurring personal liability. While personal liability is a key consideration in order to protect the entrepreneur's interest, the issue of bankruptcy under the 2005 code must also be accounted for. This is essential in light of the anemic success rate for small business. This concern is further magnified in light of the number of practitioners that seek Chapter11 protections, but are eventually liquidated.

The bankruptcy provisions and reporting requirements diverge from other reporting requirements that entrepreneurs are generally accustomed to. As a newly formed small business, the majority of entrepreneurs launch limited liability companies (LLC's). Under an LLC, the traditional formalities associated with corporate business structures are notably relaxed, providing the entrepreneur with immense flexibility in the daily operation of the organization. Likewise, as new business structures emerge, such as the closely-held corporation, the focus on formalities is deemphasized. As a result, any small business practitioners are unaccustomed to maintaining comprehensive records.

While maintaining records is an admirable goal, and can assist creditors, the court, and entrepreneur in understanding the financial condition of the business, the bankruptcy reporting requirements are unduly excessive. The reporting requirements require significant time, and can be expensive. As a result, the reporting requirements can stifle the entrepreneur's ability to emerge from bankruptcy. These restrictive reporting requirements substantially increase the likelihood that an entrepreneur's chapter 11 filing will eventually be converted into liquidation.

In order to avoid liquidation, it is critical for the entrepreneur to invest the time and energy into both complying with the heightened reporting requirements, as well as reevaluating the critical success factors, as mentioned above, in order to emerge from bankruptcy. During this process, the entrepreneur should focus on cost control as well as devising a strategy that minimizes weaknesses within the current operation, and capitalizes upon opportunities within the industry. During the reevaluation process, the entrepreneur should have information that was not present during the initial formation stages, as the entrepreneur should have a more comprehensive understanding of the industry.

While the 2005 revision thwarts the entrepreneur's ability to emerge from bankruptcy, there is some compelling empirical research to espouse Congress's initiative. One of the primary purposes of Chapter 11 is to preserve the going-concern surfeit of a financially distressed business, capitalizing upon the synergy of its assets as employed in their current configuration (Baird and Morrison, 2005). Under this view, the financially distressed small business is uneconomically consuming scarce resources. Under a labor economics rationale, the assets would be best utilized by liquidating the businesses assets in order to maximize the return on the assets (Baird and Morrison, 2005). As a result, the entrepreneur needs to be prepared to overcome many of the inequities associated within the 2005 bankruptcy code.

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THE STUDY OF LEADERSHIP IN SMALL BUSINESS ORGANIZATIONS: IMPACT ON PROFITABILITY AND ORGANIZATIONAL SUCCESS

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ABSTRACT

Failures of small businesses in the United States continue to increase. This research examined small construction businesses from Pennsylvania and West Virginia to determine if there was a relationship between leadership style and organizational profitability and success. Leadership was measured through perceptions of leaders, managers, and employees from small construction companies using the Multifactor Leadership Questionnaire survey. A quantitative correlational design tested the relationships between leadership and organizational profitability (based on employee effectiveness) and organizational success (based on employee satisfaction). The findings revealed stronger and more positive relationships between transformational and transactional leadership styles and dependent variables than between laissez-faire leadership style and dependent variables. Correlational r-values illustrated the relationships between transformational, transactional, and laissez-faire leadership styles and employee effectiveness and employee satisfaction.

INTRODUCTION

In the 21st century, both public and private business owners visualized economic growth, but growth slowed when unethical leaders became obsessed with satisfying their personal needs instead of the needs of their customers and their employees. Such unethical practices had an impact on economic growth, which affected unemployment, capital investment for small businesses, the loss of individual pensions, and small business bankruptcy. Economic uncertainty began to surface with the failure of the e-business sector, Enron, and WorldCom (Luthans, Luthans, Hodgetts, & Luthans, 2001). The U.S. economy was in decline before 9/11 because of reduced consumer spending, increasing unemployment, and declining economic growth (Shaw and Shapiro, 2002). The 9/11 attack accelerated the economic decline, brought additional uncertainty to the declining economy, and sounded the alarm for leadership at all levels to concentrate on their organization's success (Luthans et al., 2001, p. 4).

A large component of the U.S. economy stems from successful small businesses. Small business leaders use a variety of resources to position an organization to achieve its goals and objectives (Howard, 2006, pp. 73-88). The U.S. economy enjoyed remarkable economic success from 1996 through 2006, as indicated by the important economic measurement called *rate of productivity growth* (Acs & Szerb, 2007). Because of improved economic conditions, the demand for small businesses increased in this market (Fuller, 2003).

BACKGROUND OF PROBLEM

A small business is independently owned and operated and not dominant in its field of operation (U.S. SBA, Office of Advocacy, 2004). A small business is a single entity that conducts business transactions, such as services or industrial operations (The U.S. Census Bureau, 2005). Over the past 30 years, the United States has witnessed a powerful emergence of small businesses (Kuratko, 2007). America's small businesses generated more than half of the nation's GDP, served as the principal source of new jobs in the U.S. economy, and employed more than 50% of the private workforce, which grew to 51% (Wong, 2002; Howard, 2006). In 2002, small businesses accounted for 75% of total employment growth in the U.S. ("Vital Role," 2002). Small businesses are essential to the growth of the U.S. economy, as demonstrated by the number of organizations increasing 452,640 from 2000 to 2004 (U.S. SBA, Office of Advocacy, 2004). Statistics from the U.S. Census Bureau (2005) on small businesses listed over 13.2 million organizations in 2004. Six hundred seventy two thousand new small businesses were created in 2005, the largest number in U.S. history (Kuratko, 2007). The increase of small businesses aided economic growth and created new employment. Small business growth was associated with target markets, increased sales, profitability, achieving organizational goals, and competition.

Statement of Problem

The failure of small businesses has been a problem creating unemployment, affecting the U.S. gross domestic product (GDP) and slowing economic growth. Nine out of 10 small businesses fail in the first three years (Headd, 2003). Small businesses without organizational goals and objectives remain in existence only 2 or 3 years (Beaver, 2003, p. 17). Failure then becomes a concern of both internal and external stakeholders. In 2002, 21,078 small businesses closed because of failure (Knaup, 2005). In 2005, over 32,400 small businesses failed, which represented a 9% increase over 2004 ("The World Slow-Down," 2006). Beaver (2003) researched data from Dun and Bradstreet and found the primary cause of small business failures in the United States was management incompetence as leaders.

Poor Leadership in Small Businesses

According to Perry (2001) and Beaver (2003), poor leadership practices in small businesses are the cause of many small business failures. Gordon and Yukl (2004) advocated more research on leadership skills relevant to turbulent small business environments. In 1980, Beaver (2003) examined records from 200 bankrupt small businesses, from which was concluded the primary failure of the organizations was a lack of leadership knowledge and neglect by management. Leadership style is critical to the success of a small business. Pellerin (2007) indicated the failure rate for small businesses is extremely high, and discovered the failure rate of small business after the third year is 62%; although, the Pellerin study did not address management incompetence. Ninety percent of small businesses fail in the first 10 years of existence (Scheers and Radipere, 2007). Scheers and Radipere were of the opinion that small business failures were caused by poor leadership and management skills. A successful economy depends upon small businesses being productive and competitive (Beaver, 2003). Small businesses are engines of economic growth through employment and innovation (Fuller, 2003). Organizational failures in the early 21st century emphasized the need for leadership and personal commitment from organizational decision makers, which becomes critical for organizational success (Chen, 2004).

Purpose of the Study

The purpose of the research was to examine how leadership styles influence small businesses' profitability and success. The researchers started with the premise that for a small business to be successful it must have robust leadership; transformational and transactional leadership styles are essential for expanding small businesses; and, the right leadership style in small businesses leads to new competition, encourages economic growth, expands social mobility, and extends employment opportunities to individuals. The theoretical model of leadership exhibits which robust leadership style best affects small business profitability and success. To test these premises, the researchers focused their study on leadership styles in small construction companies to determine if there is a relationship between leadership styles and profitability (based on employee effectiveness), or success (based on employee satisfaction).

Significance of the Study

This quantitative, correlational research focused on the impact of leadership style on profitability and success in small specialty construction businesses located in Pennsylvania and West Virginia. Small specialty contractors were electrical, plumbing, heating, excavating, and paving organizations. At the time of the study, the economic outlook of small construction businesses in Pennsylvania and West Virginia remained uncertain based on competition, fewer federal-and state-funded projects, the ageing collective bargaining workforce, and organizational culture. In a small business environment of economic uncertainty, leaders can have a positive influence on reaching profitability, so to resolve these small construction business concerns, owners either must become effective leaders or must hire top executives with leadership abilities. New entrepreneurs seek small construction business success, and small construction business firms struggle to find individuals with leadership qualities to successfully operate construction organizations (Tulacz, 2007).

REVIEW OF THE LITERATURE

Small construction businesses are needed for future economic growth, consumer stability, and full employment (Fuller, 2003), as profitable and successful small construction businesses contribute to increasing the U.S. GDP and national employment. According to the SBA industry chart for 2004, the small construction business industry totaled 751,098, or 5.66%, of small businesses in the U.S. Between 2000 and 2003, the number of small construction businesses and their related employment dropped (Fuller, 2003). In July, 2006, the rate of small construction company startups fell 3% (Lanigan, Ryan, Malcolm, & Doyle, 2006). Arditi et al. (2000) stated many failures in the construction industry occurred because owners and executives made managerial decisions affecting the fate of the organization without competent business knowledge. Insufficient profits, inefficiency, and poor productivity were other internal administrative factors contributing to failures (Arditi et al., 2000). The human factors consisted of lack of business knowledge, lack of managerial experience, and poor working habits. Chen (2004) suggested that these types of organizational inequities emphasized the need for leadership and personal commitment from organizational decision makers, which are critical for organizational success. Arditi et al. supported Chen's statement by indicating that human and internal factors (representing 46.73% of all reasons for failure) influenced the outcome of the transformation process and determined the success or failure of the organization. With increasing numbers of construction projects available, it is essential that small construction businesses establish robust leadership to avoid failure (Tulacz, 2007). The small construction business leader is responsible for motivating employees to embrace the organization's vision to achieve organizational goals and objectives.

Leadership in Small Construction Organizations

Leadership theory has been examined over the years in various research studies. The general view of leadership is that success or failure in producing results depends on the character of the leader—personal traits, culture, and behavior—and not on any generalized concept of leadership (Wren, 1994). Effective leadership is viewed as essential for organizational success (Hernez-Broome & Hughes, 2004). Years of leadership research has shown that not all organizational leaders have the same leadership styles in achieving success (Bass, 1990). Previous researchers sought to discover only one or two leadership attributes that were common for all extraordinary leaders

(Zenger & Folkman, 2002), but found there was no single leadership pattern that guided all organizations or all leaders within successful organizations.

Small business leaders have a strong influence on how employees achieve organizational goals (Peters, 2005). Small business leaders need a better understanding of leadership styles to show development and progress in achieving the organization's goals and objectives. Research on small businesses provides the small business leader and owner the understanding of what leadership activities are necessary to position the organization to achieve its goals and objectives. Small business leaders establish the working atmosphere of their business through their leadership style. Leaders of small business construction organizations must manage all business and operational functions. Leadership has an important role in organizational effectiveness (Howard, 2006; O'Regan et al., 2005). Lack of employee empowerment creates unsatisfied employees who may not work toward achieving organizational goals and objectives. Leadership is crucial in holding together a healthy work environment (Shirey, 2006, pp. 256-268).

Encouragement from leaders gives employees inspiration to achieve personal satisfaction. Giving employees the authority to make decisions demonstrates flexibility in leadership, which O'Regan et al. viewed as an attribute of transformational leadership style and a critical factor for increasing profitability in the small business. Structure in a small business is usually informal or flat, which allows all employees to have a better understanding of the daily business operations. Non-performance of leadership responsibilities shows the leaders' inability to achieve profitability and success, which leads to failure.

Small Construction Organizations in West Virginia and Pennsylvania

This section of the literature review bridges the gap between leadership and small construction business success and profitability, and focuses the review on small construction companies studied in West Virginia and Pennsylvania. The SBA Office of Advocacy (2003a, 2003b) numbered West Virginia small construction businesses at approximately 279,742; Pennsylvania had 233,331 small construction businesses. The SBA Office of Advocacy (2003b) indicated 3.6%, or 8,400, of Pennsylvania small businesses failed from 1999 to 2001, and West Virginia small construction business failures were 9.5%, or 4,177, from 1999 to 2001. The figures reflected a net decrease of more than 12,500 small construction businesses in Pennsylvania and West Virginia. Because of many construction company failures, small construction businesses in Pennsylvania and West Virginia were searching for effective leadership.

Small construction companies struggled to find the right formula to remain successful in their industry. Effective leadership is necessary for small construction businesses to achieve profitability and success that would ensure business survival (McLean, 2005). The current study examined which leadership style is most effective in small construction business operations, so organizations can achieve profitability and success. Small construction businesses are deeply embedded in the overall economy, and are codependent with large corporations and with public and private projects. Small construction businesses continue to face challenges to stay profitable and successful in a turbulent economy. Owners and leaders of small construction businesses must take responsibility for situations that are created daily. Playing it safe and deflecting leader responsibility to other employees within the organization does not exemplify true leadership (Fuller, 2003). A great leader helps service others before himself/herself and is willing to be accountable for decisions. Responsibility is an element of a good leader; leaders are vulnerable by accepting responsibility for their mistakes and weaknesses. Effective communication gives leaders an avenue to discuss all activities that occur within the organization (Antonioni, 2003). If a small business leader encounters an unethical activity causing conflict of duties or values, the owner and leader must choose between alternatives to resolve this conflict (Calhoun, 2004). The ability of the leader to use human resources properly distinguishes great leaders, as well as successful organizations. Small business construction leaders must lead by example so employees will follow their example, accept responsibility, and encourage other employees to be efficient in performing their tasks and duties (Spinelli, 2006). Leadership skills and managerial skills are required to organize resources needed to operate the small business (Scheers and Radipere, 2007).

RESEARCH DESIGN

The research investigated transformational, transactional, and laissez-faire leadership styles to determine if there is a relationship with profitability and organizational success. The unpredictable nature of the construction industry in Pennsylvania and West Virginia carried a high risk of failure. Although the small construction business industry had been vibrant and growing at one time, the need to move small construction businesses forward in an era of declining sales was vital. The construction industry had once enjoyed a sound increase in market segments for future revenues ("FMI sees construction growth", 2004). Small construction businesses have since failed for many reasons, such as strong competition, unprofitable projects, being under-capitalized, and having unsatisfied employees. Poor leadership affected decisions related to small construction business operations. There is strong evidence confirming that leadership is a key factor in producing quality performance and efficiency (Vance and Larson, 2002). The construction industry employs 6.4% of the total U.S. workforce (Druml Group, Inc., 2005), and the future of the industry depends on the ability of organizations to respond to key leadership decisions made by small business owners and executives.

Leadership is critical in small business construction organizations to achieve profitability. Effective leadership is viewed as essential for organizational success (Hernez-Broome & Hughes, 2004). Therefore, the research questions were:

1. Is there a relationship between transformational, transactional, and laissez-faire leadership styles and profitability and success of small construction businesses?

2. How does the relationship between laissez-fair leadership and employee effectiveness and satisfaction affect profitability and success?

Leadership styles are key components that drive employee performance toward achieving the organization's goals and objectives (O'Regan, Ghobadian, and Sims, 2005). The relationships between transformational, transactional, and laissez-faire leadership styles are unclear to many small construction business owners (Humphreys, 2001). The four null hypotheses used predicted no relationship between variables in the general population (Creswell, 2004). The four alternative hypotheses predicted a relationship existed between the independent variables and the dependent variables (Creswell, 2004). The following null hypotheses and alternative hypotheses were developed.

$H1_0$: *There is no relationship between transformational or transactional leadership style and organizational profitability.*

$H1_a$: *There is a relationship between transformational or transactional leadership style and organizational profitability.*

$H2_0$: *There is no relationship between transformational or transactional leadership style and organizational success.*

$H2_a$: *There is a relationship between transformational or transactional leadership style and organizational success.*

$H3_0$: *There is no relationship between laissez-faire leadership style and organizational profitability.*

$H3_a$: *There is a relationship between laissez-faire leadership style and organizational profitability.*

$H4_0$: *There is no relationship between laissez-faire leadership style and organizational success.*

$H4_a$: *There is a relationship between laissez-faire leadership style and organizational success.*

Leadership style was the established independent variable. Profitability and organizational success were the dependent variables. Small businesses become efficient through innovation and performance, which enables small construction businesses to take risks in achieving profitability and success. Profitability is also driven by efficiency in obtaining organizational goals and objectives, and is a measurement of an organization's financial performance. In any small business, there are three key drivers of success: vision, resources, and organization (Raina, Chanda, and Mehta, 2003). As described later in the Instrumentation section, we used the MLQ Leader Form to collect data from leaders describing their leadership style and the impact they had on employee performance, and the MLQ Scoring Key Form 5X to score data for measuring employee effectiveness and satisfaction. In this study, we measured profitability through employee effectiveness scores, and organizational success through employee satisfaction scores.

Transformational, transactional, and laissez-faire leadership styles comprised the independent variables that influenced the outcome of the dependent variables of small business profitability and organizational success. The independent variables were measured using scores from the Multifactor Leadership Questionnaire survey (MLQ), which provided evidence showing the relationship of the independent variables to small construction business profitability and organizational success. Given the nature and consistency of change in our economic environment and the challenges facing small construction businesses, leadership is essential for making the right decisions to succeed (Bennis, 2000). To survive in Pennsylvania and West Virginia, small construction businesses required strong leadership. Robust leaders conquer the volatile, turbulent surroundings that sometimes suffocate small businesses. The slow suffocation of a small business starts its downward spiral to failure (Bennis, 2000).

Transformational leadership is "a process that is systematic, consisting of a purposeful and organized search for changes, and the capacity to move resources from areas of lesser to greater productivity" (Bass, 1990, p. 134). Visser et al. (2005) described transformational leadership as "the ability to inspire and motivate followers to achieve results greater than originally planned" (p. 53). These descriptions emphasize that motivation of human resources leads to greater production and higher performance. Moving human efforts from areas of lesser to greater productivity motivates and inspires individuals to perform at their highest productivity. Transformational leaders work closely with employees and adapt their characteristics to achieve company growth and success. A transformational leader's behavior includes charisma, inspirational motivation, intellectual stimulation, and individualized consideration (Harland, Harrison, Jones, and Reiter-Palmon, 2005). In a successful organization, all individuals work for the same common goals and objectives. A transformational leader brings confidence from which individuals draw. When individuals believe in themselves, they create self-confidence to address any task assigned to them (Hesselbein, Goldsmith, and Beckhard, 1996). A follower receives the necessary resources from a transformational leader to build self-confidence. Transformational leaders have the ability to move employees beyond their self-confidence so the employees commit to the organization's vision (McGuire & Kennerly, 2006).

A transactional leader exchanges the wants of a leader for the wants of an employee. The wants of employees are considered their needs. A transactional leader satisfies employee needs through recognition and rewards for tasks performed for the organization (Shriberg et al., 2002).

Individuals receive rewards for achieving the goals of the organization through their performance, with the help of the transactional leader. Bass (1990) supported Shriberg et al., stating the leader provides a benefit for the individual and in return, the individual provides the leader with the highest performance, innovation, and achievement of the organization's goals and objectives. The transactional leadership style ensures that individuals have the proper resources and knowledge to perform the tasks needed for organizational success. In return, individuals are rewarded for their efforts and accomplishments. This relationship between the individual and the transactional leader supports the meaning of exchange between the leader and individual (Tarabishy, Solomon, Fernald, & Sashkin, 2005).

A transactional leader expresses positive outcomes to employees for performing their duties and also focuses on employee mistakes and complaints. Leadership drives the success of a small business, and thus, is essential for accomplishing organizational success (Harland et al., 2005). The transactional leader sets the path and direction needed to obtain these goals and objectives. Rewards are used so individuals concentrate on the tasks and duties of the organization. Transactional leaders emphasize process development in setting goals, directing, and striving to manipulate and control the situation (McGuire and Kennerly, 2006).

McGuire and Kennerly (2006) described the laissez-faire leadership style as ineffective in promoting purposeful employee communication and said it contributes to an organization's demise. Under this leadership style, no one takes responsibility for achieving the organization's goals and objectives. Eagly et al. (2003) indicated laissez-faire leadership style was marked by failure in taking responsibility to lead an organization toward its goals, objectives, and vision. Lack of leader responsibility leads to employee self-teaching, employee freedom to act accordingly, and leaders who do not care about organization results (Bass, 1990). A laissez-faire leader's behavior focuses on remaining uninvolved, avoiding decisions, and delaying responses to employees' questions (Harland et al., 2005). Employees need guidance to be effective in their performance. Employees not performing at their ability lead to organizational non-profitability. Within such a leadership atmosphere, the organization operates by itself. Some small businesses use this leadership because the owner and leader lack knowledge and understanding of the industry environment. Laissez-faire leadership style is detrimental to individual performance. All individuals need motivation, encouragement, and direction in achieving the organization's goals and objectives. Without motivation, encouragement, and direction, the individual becomes non-productive (Bass, 1990).

Administration and Procedures

The research design for the current quantitative research study was correlational. Creswell (2004) defined correlational design as a "statistical technique describing and measuring the degree of association or relationship between two or more variables of sets of scores" (p. 361). One independent variable measured possible relationships between two dependent variables. The research was designed using the Pearson *r* correlation to assess if a relationship was present between leadership styles and the two dependent variables of profitability and organizational success, and if so, to determine the direction and strength of the relationship. Creswell (2004) defined an explanatory research design as a correlation design in which two or more variables had variances or changes, with one variable showing change in the other (p. 363). In the current study, leadership style was the explanatory variable predicting the dependent variables, profitability and organizational success.

Howard (2006) referred to small businesses as organizations with fewer than 500 employees and sales between \$7.5 million and \$50 million. We used state and local Chambers of Commerce, the Yellow Pages, and the Internet to locate and identify small construction businesses with 100 to 200 employees, or \$10 million to \$50 million in sales. The search identified 11 construction organizations that fit within the specified parameters: six from Pennsylvania and five from West Virginia. The 11 construction organizations employed a total of 120 people who met the criteria for eligible participants, including owners, project managers, managers, and administrative employees from small construction businesses located in Pennsylvania and West Virginia. Six organizations, with a total of 48 eligible employees, participated in the research study. Three participating organizations were from Pennsylvania and three were from West Virginia. The 48 participants in this study were owners, executives, project managers, managers, and administrative employees who were age 21 and older from selected small construction businesses found in Pennsylvania and West Virginia. The study sample contained 8 leaders and 40 employees, including both male and female.

Five companies returned the survey packets without allowing employees to complete the surveys: this represented 72 of the 120 surveys distributed. Although each owner phrased it differently, the primary concern was fear that employees would discuss the questions among themselves after completing the surveys and that discontent could surface from the discussions. Owners did not seem concerned about issues of external confidentiality, but rather about internal confidentiality.

Validity of Sampling Size

The variability of the population was a key component in determining an adequate sample size. The actual variability of the measurements was used to validate the sample size of the study. We used a statistical approach to validate the original sample size of 48 as large enough to minimize sampling error and to support the research conclusions. Even a small sample size can be representative of a highly homogenous population (Lind, Marchal, and Wathen, 2005). We calculated the minimum acceptable sample size (n) using the variability of the measurement (standard deviation or S), and an acceptable margin of error (E) with the required level of confidence (z) for determining the outcome. An acceptable margin of error was ± .2. The level of confidence desired in the study was 95%. The formula below was used to verify the sample size of the study (Lind et al., 2005, p. 316).

$$n = \left(\frac{z \cdot S}{E} \right)^2$$

The difference between the sample measurements (statistics) and the population measurements (parameters) results in the sampling error (Lind et al., 2005). The object was to minimize the sampling error by providing a sample representative of the population. The relatively low variability of the response measurements in the study supported using a sample size of 48 at a minimum of 95% confidence level. The sample statistics were within the ± .2 of the true population.

Instrumentation

For data collection, we used three surveys with 135 questions from Bass and Avolio's (2000) MLQ. The MLQ was tested in previous leadership studies; for example, Casimir et al. (2006) used the MLQ to measure transformational leadership and transactional leadership, and based on the results, the leadership measurements displayed satisfactory internal consistency. The MLQ was designed to study leadership within organizations, and the MLQ had been used to measure the full range of leadership styles since 1980 (Spinelli, 2006). The MLQ also met the criteria for the current leadership study and provided information needed to examine leadership.

The three MLQ survey forms used were: *MLQ Rater Form* – to collect data from employees rating the leaders' leadership style; *MLQ Leader Form* – to collect data from leaders describing their leadership style and the impact they had on employee performance; and, *MLQ Scoring Key Form 5X* – to score data for measuring employee effectiveness and satisfaction. The *MLQ Scoring Key Form 5X* was a comprehensive survey that measured the full range of leadership styles. The dependent variable, profitability, was measured through employee effectiveness scores, and organizational success was measured through employee satisfaction scores. Information regarding the three MLQ survey forms may be obtained by contacting the survey owner at http://www.mindgarden.com.

The leadership study performed by Casimir et al. (2006) revealed a correlation between transformational and transactional leadership, trust, and performance, showing a significant positive correlation with all the dependent variables in the study. Block (2003) also used the MLQ survey in her research study. The results indicated the leadership style examined was significantly related to employee performance and perceptions of organizational culture. The research studies cited above used the MLQ, supporting the validity and reliability of the survey.

We used a 5-point Likert-type scale to measure the data collected for the impact of leadership styles on profitability and organizational success, as follows: 4 = *frequently if not always,* 3 = *fairly often,* 2 = *sometimes,* 1 = *once in a while,* and 0 = *not at all*.

The correlation coefficient measured the magnitude and direction of the relationship. The statistical values of the independent variable and the dependent variables were tested to determine if there was a positive or negative relationship between leadership styles and organizational profitability and success, and if any relationship found in the sample was significant.

The degree of relationship between leadership styles and profitability and organizational success falls between –1 and +1. As the correlation coefficient moves towards either –1 or +1, the relationship of the independent variable and dependent variables becomes stronger. The level of significance used to examine the null hypotheses in the study was $a = 0.05$. The level of significance, $a = 0.05$, was used to determine the critical value from the PPMC table: if the absolute value for the r was greater than the critical value listed in the table, then the null hypotheses was rejected.

Validity and reliability are two key concepts in measuring the quality of leadership (Ulijn, 2000). The content validity of the MLQ survey has been tested in other research studies with excellent validity and reliability reported worldwide ("The Multifactor Leadership Questionnaire", 2005; Harland et al., 2005; Sosik, Potosky, and Jung, 2002; Shin and Zhou, 2003; Humphreys, 2001; Casimir et al., 2006). For example, Avolio and Bass (2004) collected 14 samples to validate and cross-validate the MLQ survey and reported the reliabilities and validity for each leadership factor scale ranged from 0.74 to 0.94. Based on the high reliability and validity values, the MLQ survey should collect valid data measuring the relationship between leadership and company profitability and success.

RESULTS

In addition to completing the MLQ survey, participants were asked to report their gender and position within the organization. Table 1 illustrates gender distribution of leaders, project managers, managers, and administrative employees. The distribution of the population between male and female participants was unbalanced, but presented an accurate representation of small construction businesses. Six administrative employees who completed the *MLQ Scoring Key Form 5X* survey declined to identify their positions.

Table 1: Gender Distribution of Respondents (N = 48)

Company Position	Male		Female		No Response	
	n	%	*n*	%	*n*	%
Leader	8	16.67	0	0	0	0
Project Manager	3	6.25	0	0	0	0
Manager	8	16.67	0	0	0	0
Administrative Employee	10	20.83	13	27.08	6	12.50

Results Relevant to Research Questions

Research Question One: Is there a relationship between transformational, transactional, and laissez-faire leadership styles and profitability and success of small construction businesses? This question addressed elements of different leadership styles and which leadership attributes motivated individuals. Motivation encourages individuals to perform at a level where the organization achieves profitability and success. The *MLQ Leader Survey* and the *MLQ Rater Survey* instruments evaluated the leader's role within the organization. The *MLQ Scoring Key Form 5X* survey, completed by organizational leaders, project managers, managers, and administrative employees rated leadership necessary to achieve organizational profitability and success. The results of effective leadership from the *MLQ Leader Survey* yielded a mean score of 2.65 (*SD* = 0.51). The mean score relates to transformational and transactional leadership styles, which illustrates these styles as effective leadership to achieve profitability and organizational success. The coefficient of variation (CVAR) of effective leadership was 19.25%. The leader responses were a little less variable and more consistent due to the slightly lower CVAR percentage. The *MLQ Rater* score*s* for leadership effectiveness yielded a mean score of 2.50 (*SD* = 0.60). The large standard deviation scores revealed that variability existed between the leaders and employees. The coefficient of variation (CVAR) of effective leadership rated by the employees was 24%. Employees had a higher CVAR than leaders did, indicating that effective leadership was essential for achieving profitability and organizational success.

Table 2: Leadership Dimension to Organizational Profitability (N = 48)

Dimension	Factor	*M*	*SD*
Transformational	Idealized Influence (Attributed) (IIA)	3.2	0.48
	Inspirational Motivation (IM)	3.27	0.51
	Individual Consideration (IC)	3.14	0.5
	Idealized Influence (Behavioral) (HB)	3.11	0.54
	Intellectual Stimulation (IS)	3.07	0.56
Transactional	Contingent Reward (CR)	3.08	0.47
	Management by Exception (Active) (MBEA)	3.09	0.53
	Management by Exception (Passive) (MBEP)	2.42	0.68
Laissez-Faire	Laissez-Faire	2.15	0.36

Using the MLQ Scoring Key Form 5X, organizational profitability was measured by employee effectiveness. The mean and standard deviation for leadership that measured profitability, as exhibited in Table 2, showed which attributes were associated with transformational, transactional, and laissez-faire leadership styles and displayed their respective scores.

Transformational leaders accumulated a mean score of 3.16 (*SD* = 0.52), transactional leaders accumulated a mean score of 2.86 (*SD* = 0.56), and laissez-faire leaders accumulated a mean score of 2.15 (*SD* = 0.36). The mean measurement for transformational (*M* = 3.16) and transactional (*M* = 2.86) leadership attributes indicated that employees perform at a high level under transformational and transactional leadership. Laissez-faire (*M* = 2.15) leadership attributes produced a lower mean score, illustrating that this style of leadership did not motivate employees in small construction businesses to achieve organizational profits and success.

Table 3: Leadership Dimension to Organizational Success (N = 48)

Dimension	Factor	*M*	*SD*
Transformational	Idealized Influence (Attributed) (IIA)	3.25	0.53
	Inspirational Motivation (IM)	3.32	0.57
	Individual Consideration (IC)	3.20	0.56
	Idealized Influence (Behavioral) (HB)	3.16	0.60
	Intellectual Stimulation (IS)	3.12	0.62
Transactional	Contingent Reward (CR)	3.14	0.53
	Management by Exception (Active) (MBEA)	3.13	0.59
	Management by Exception (Passive) (MBEP)	2.48	0.73
Laissez-Faire	Laissez-Faire	2.20	0.42

The MLQ Scoring Key Form 5X survey was used to measure organizational success from the attribute employee satisfaction. Table 3 shows the mean and standard deviation of leadership attributes contributing to organizational success. The leadership attributes yielded an accumulated mean score of 3.21 (*SD* = 0.58) for transformational leadership, 2.92 (*SD* = 0.62) for transactional leadership, and 2.20 (*SD* = 0.42) for laissez-faire leadership. The high mean scores for transformational and transactional leadership revealed that employee satisfaction was encouraged by leaders in a positive environment for achieving organizational success. The lower mean and standard deviation score for laissez-faire leadership indicated a weak environment for achieving organizational success. Analysis of the data revealed that the laissez-faire leadership style had a weak influence on employees for achieving organizational profitability and success.

Research question Two: How does the relationship between laissez-fair leadership and employee effectiveness and satisfaction affect profitability and success? The *MLQ Scoring Key* Form 5X survey measured profitability and organizational success through employee effectiveness and satisfaction. Statistical results from Tables 4 and 5 reveal that laissez-faire leadership had lower mean scores than did the other leadership styles, illustrating that leaders were weak in achieving employee effectiveness and employee satisfaction.

Table 4: Leadership Dimension to Employee Effectiveness (N = 48)			
Dimension	Factor	*M*	*SD*
Transformational and Transactional			
Effectiveness	Profitability	3.05	0.53
Laissez-Faire			
Effectiveness	Profitability	2.15	0.36

Table 4 illustrates the mean and standard deviation values from owners and employees completing the MLQ Scoring Key Form 5X survey, which measured employee effectiveness relating to leadership styles. The low mean and standard deviation values for laissez-faire leadership style illustrate that the participants viewed this leadership style as weak for achieving profitability.

Table 5: Leadership Dimensions to Employee Satisfaction (N = 48)			
Dimension	Factor	*M*	*SD*
Transformational and Transactional			
Satisfaction	Organizational Success	3.10	0.59
Laissez-Faire			
Satisfaction	Organizational Success	2.20	0.42

Table 5 illustrates owner and employee participants' responses to the *MLQ Scoring Key Form 5 X surveys*, which measured employee satisfaction relating to leadership styles. The laissez-faire leadership style yielded a mean score of 2.20 (*SD* = 0.42), compared to transformational and transactional leadership styles yielding a mean score of 3.10 (*SD* = .59). The mean scores and standard deviations show a difference between transformational, transactional, and laissez-faire leadership. The high mean scores and standard deviations for transformational and transactional leadership illustrate that the participants viewed these leadership styles as stronger than laissez-faire leadership. Employee satisfaction was greater under transformational and transactional leadership. The low mean and standard deviation values illustrated in Tables 4 and 5 for laissez-faire leadership style indicate a weak environment and lack of leadership responsibility for achieving profitability and organizational success. Under the laissez-faire leadership style, leaders did not take responsibility for motivating and encouraging employees to achieve organizational profitability and success.

Results Relevant to Hypotheses

We used results from the *MLQ Scoring Key Form 5X* survey to collect and analyze data to identify statistical relationships between leadership styles and organizational profitability and success. The relationship between the independent variables (leadership styles) and the dependent variables (profitability and organizational success) were examined using quantitative correlation coefficients. We used WXLSTAT 2008 to calculate the correlation coefficient *r* to analyze the hypotheses. Table 6 illustrates the correlation between transformational, transactional, and laissez-faire leadership and profitability using employee effectiveness.

Table 6: Correlation Matrix, Leadership to Employee Effectiveness (N = 48)

Subscale	1	2	3	4
1. Effectiveness	—			
2. Transformational	0.669	—		
3. Transactional	0.587	0.803	—	
4. Laissez-faire	0.167	0.228	0.06	—

Note. Critical value = ± .165, *a* =.05 (two-tail)

The correlation matrix in Table 6 indicates a strong correlation between transformational and transactional leadership and profitability, and a very weak relationship between laissez-faire leadership and profitability.

Table 7 illustrates the correlations between transformational, transactional, and laissez-faire leadership and organizational success using employee satisfaction.

Table 7: Correlation Matrix, Leadership to Employee Satisfaction (N = 48)

Subscale	1	2	3	4
1. Satisfaction	—			
2. Transformational	0.478	—		
3. Transactional	0.503	0.803	—	
4. Laissez-faire	0.181	0.228	0.06	—

Note. Critical value = ± .165, *a* =.05 (two-tail)

The correlations in Table 7, measured through employee satisfaction, indicate a moderate correlation between transformational and transactional leadership and organizational success, and a weak relationship between laissez-faire leadership and organizational success.

Using the Pearson product moment correlation (PPMC) test, with *a* = .05, the critical values were ± .165. For hypothesis ($H1_0$), transformational leadership exhibited r = .669, and transactional leadership exhibited r = .587, relating to organizational profitability, which are greater than the critical value. The null hypothesis ($H1_0$) was rejected. We concluded that the correlations between transformational and transactional leadership and employee effectiveness were significant in the population. The relationship between transformational leadership and employee effectiveness (correlation coefficient r = .669) was positive and strong in the population. The relationship between transactional leadership and employee effectiveness (correlation coefficient r = .587) was positive and moderately strong. The results of the test were statistically significant, rejecting the null hypothesis ($H1_0$). The alternative hypothesis ($H1_a$) was assumed true; indicating significant relationships between transformational and transactional leadership and profitability.

Hypothesis ($H3_0$) laissez-faire leadership exhibited r = .167 relating to organizational profitability. Using the PPMC test, with *a* = .05, the critical values were ± .165. The r = .167 was greater than the critical value, and the null hypothesis ($H3_0$) was rejected. The relationship between laissez-faire leadership and employee effectiveness (correlation coefficient of r = .167) was positive but very weak in the population, which was based on random chance and not on a true relationship. The results of the test were statistically significant rejecting the null hypothesis ($H3_0$). The alternative hypothesis ($H3_a$) was assumed true; indicating a very weak relationship between laissez-faire leadership and profitability. . Using the PPMC test, with *a* = .05, the critical values were ± .165. For hypothesis ($H2_0$), transformational leadership exhibited r = .478, and transactional leadership exhibited r = .503, relating to organizational success, which were greater than the critical value. The null hypothesis ($H2_0$) was rejected. The correlation between transformational and transactional leadership and employee satisfaction was significant in the population. The relationship between transformational leadership and employee satisfaction (correlation coefficient r = .478) was positive and moderate in the population. The relationship between transactional leadership and employee satisfaction (correlation coefficient r = .503) was positive and moderate in the population. The results of the test were statistically significant, rejecting the null hypothesis ($H2_0$). The alternative hypothesis ($H2_0$) was assumed true; indicating significant relationship between transformational and transactional leadership and organizational success.

Using the PPMC test with *a* = .05, the critical values were ±.165. For hypothesis ($H4_0$), laissez-faire leadership exhibited r = .181 relating to organizational success, which was greater than the critical value. The null hypothesis ($H4_0$) was rejected. The relationship between laissez-faire leadership and employee satisfaction (correlation coefficient r = .181) was positive and significantly weak in the population and based on random chance and not on a true relationship. The alternative hypothesis ($H4_a$) was assumed true. There was a weak relationship between laissez-faire leadership and organizational success.

CONCLUSIONS AND RECOMMENDATIONS

There were correlations between transformational (r = 0.669) and transactional leadership (r = 0.587) styles, measured through employee effectiveness, and their effects on organizational profitability, and the relationships were positive and strong. There were correlations between transformational (r = 0.478) and transactional leadership (r = 0.503) styles, measured through employee satisfaction, and organizational success, and the relationships were positive and moderately strong. Through statistical testing of the data collected from the *MLQ Scoring Key Form 5X* survey, results showed leaders and employees supported the relationship between leadership and organizational profitability and success, and that robust leadership existed within the small construction businesses. These results supported prior research. For example, Stoker et al. (2001) stated that effectiveness and performance correlated with innovative leadership. McLean (2005) stated that effective leadership is necessary for small construction businesses to achieve profitability and success to ensure business survival. Masood et al. (2006) reported that optimal employee performance was achieved through transformational leadership. Transformational and transactional leaders create a positive atmosphere, inspiring and encouraging employees to perform at a high level. Transformational and transactional leaders demonstrate character, integrity, and direction to all individuals within the organization.

There was a correlation between laissez-faire leadership (r = 0.167), measured through employee effectiveness, and organizational profitability. And, there was a correlation between laissez-faire leadership (r = 0.181), measured through employee satisfaction, and organizational success. Although positive, the relationships were very weak illustrating for laissez-faire leadership, profitability and organizational success were not achieved through employee effectiveness and satisfaction. Zenger and Folkman (2002) stated that poor leadership is a reflection of ineffective leaders and unsatisfied employees, and it usually generates no profit for the organization. The weak relationship between laissez-faire leadership and profitability and success support Zenger and Folkman's findings.

No gap exists between the literature review and this study. Previous studies demonstrated that a relationship existed between leadership and employee satisfaction, employee performance, and employee motivation. The findings of the current study on transformational, transactional, and laissez-faire leadership support prior studies by Beaver (2003), Masood et al. (2006), Spinelli (2006), McGuire and Kennerly (2006), and Eagly et al. (2003).

Implications of the Study

According to Howard (2006), statistical information from Scarborough and Zimmer (2003) indicated small businesses employ 51% of the private sector, showing small businesses are critical to economic growth supporting the U.S. GDP. Activity generated by small businesses is a function of the economy, and the future U.S. economy depends on leadership in small businesses (Leebaert, 2006).

Results from this study add to the body of leadership knowledge in identifying that transformational and transactional leadership styles have a significant impact on small business organizational profitability and success. Previous research has demonstrated that transformational and transactional leadership behaviors develop the basis for robust leadership. A primary responsibility of leaders in today's small construction businesses is to provide leadership to employees to create maximum employee performance, employee effectiveness, and employee satisfaction to achieve profitability and success (Spinelli, 2006). The current study showed that robust leadership, in the form of transformational and transactional leadership styles, affects small construction business profitability and success.

This study also supports the positive and strong relationship of transformational and transactional leadership styles with employee effectiveness and employee satisfaction. Whereas, laissez-faire leadership style has a positive but very weak relationship, which has an unfavorable impact on the success of small construction businesses by not influencing small construction business profitability or success. This is important for small business leaders, since small business failures are associated with poor leadership (Perry, 2001; and Beaver, 2003).

The current findings were consistent with Spinelli's (2006) research on leadership styles and their impact on employee willingness to perform at a high level. Holland (1998) stated owners and executives are successful entrepreneurs when they focus on leadership attributes that inspire, motivate, and guide employees; namely, transformational and transactional leadership styles, and not laissez-fair.

Conclusions

The positive and strong relationships between transformational and transactional leadership styles, and profitability and organizational success, revealed that robust leadership existed within the small construction businesses. The study is especially relevant, considering the current economic conditions and the short life cycle of small businesses. The study demonstrated a strong relationship between transformational and transactional leadership, measured through employee effectiveness and employee satisfaction, which shows that leadership has an effect on organizational profitability and success. The study also demonstrated a weak relationship between laissez-faire leadership, measured through employee effectiveness and satisfaction, which supports the literature review of prior studies and demonstrates that small business failure is related to poor leadership. Laissez-faire leadership has an unfavorable effect on organizational profitability and success.

Robust leadership affects small construction business profitability and success. The results from the study may help current and future small construction business owners and managers to improve their leadership styles, so employees are motivated to adopt the organization's mission and vision.

Limitations

Sample size in the study is a limitation. Of the 11 small construction businesses identified that met the criteria, only six participated in the research study. Employees from six small construction businesses provided a sample size of 48 data points. Neuman (2003, p. 232) recommended that a small population under 1,000 data points requires a 30% sampling ratio to acquire a high degree of accuracy. Based on this information, the study met the requirements, as 48 data points were acquired from employees of the six small construction businesses found in Pennsylvania and West Virginia.

A second limitation is some leaders' unwillingness to use the *MLQ Rater Form* or participate in the MLQ survey. Some leaders were concerned with the confidentiality of the participants' responses. Leaders and individuals are often concerned about confidentiality, despite assurance that no one has access to the data other than the researcher (Casimir, Waldman, Bartram, & Yang 2006). The study applies to management and administrative employees employed by small construction businesses located in Pennsylvania and West Virginia. The study focuses on the relationship between the independent variable leadership and the dependent variables of profitability and organizational success. It is assumed that participants completing the survey did not answer the questions based on like or dislike of the leader.

Recommendations for Future Research

A study of small businesses linking transformational and transactional leadership to performance and profitability in a variety of other industries would be beneficial. Transformational leadership improves performance in a highly dynamic business environment, and retards performance in a low dynamic business environment (Ensley, Pearce, & Hmieleski, 2006). Investigating the influence of transformational and transactional leadership on profitability in high- and low-dynamic business environments might benefit small businesses.

Leadership is important for small businesses to survive, and a future research study could examine a leader's personal leadership construct. A study on leadership development could provide owners and executives with knowledge as to what type of development is necessary to enhance leadership skills and attributes to maintain employee satisfaction. The current research study on small construction businesses did not measure employee performance, but the literature review revealed that transactional and transformational leadership styles influence employee performance. A study on the relationship between employee performance and satisfaction might provide small business owners and executives with insightful knowledge.

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IS TWITTER A VIABLE COMMERCIAL USE PLATFORM FOR SMALL BUSINESSES? AN EMPIRICAL STUDY TARGETING TWO AUDIENCES IN THE SMALL BUSINESS COMMUNITY

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ABSTRACT

Entrepreneurs typically work long, arduous hours just maintaining all operations associated with their businesses. Thus, deciding to get involved in an Internet social phenomenon, which could be a passing fad, may or may not be a smart marketing move for small business owners. The excitement about Twitter is hard to avoid. Internet searches regarding Twitter's use as a marketing tool reveal thousands of hits. Although there are claims about the value of Twitter for small business marketing use, there is a lack of empirical evidence to back up grand, sweeping claims about the actual usefulness of the tool. This study was conducted to provide empirical evidence regarding Twitter's usefulness.

INTRODUCTION

The Internet community is abuzz with talk about Twitter, blogging about Twitter, and of course, tweeting on Twitter. Twitter is a mini-blogging tool that gives its users 140 characters to answer one question: *What are you doing?* The character limit makes Twitter different from other social networking sites. Simplicity makes the learning curve for Twitter short, drawing in a diverse group of users looking for a way to stay in touch with friends and family, networking with professionals, keeping up with industry news, or staying in tune with their favorite celebrity tweeters. Twitter's growth is evident, but the media suggest that businesses are flocking to Twitter looking for a simple, cheap way to market their business and communicate the latest industry news about their company. Small business owners might ask: Is Twitter a viable marketing tool for my business?

TWITTER USERS

Who is using Twitter? According to Quantcast.com (2009), a website that offers audience data for any site on the Internet, recent data indicated:

- ♦ Twitter reaches approximately 23.5 million people per month in the U.S.
- ♦ 54% are female
- ♦ 44% are between 18 and 34
- ♦ 72% are Caucasian, 14% are African American
- ♦ Typical household income is between $30 thousand and $60 thousand
- ♦ 1% of the addicts contribute 35% of the visits
- ♦ 72% are passers-by, while only 27% are regular users

With this vast audience it would seem that small businesses would be embracing social media as a part of their marketing plan.

Pear Analytics (Kelly, 2009) conducted a study to determine purposes for which people are using Twitter. They compared their research with other studies that were conducted recently, getting similar results. Their sample consisted of 2,000 tweets from the public timeline every 30 minutes for two weeks. The resulting tweets were then categorized into six areas: news, spam, self-promotion, pointless babble, conversational, and pass-along value. Here are their findings:

Table 1: Twitter Uses

Category	Number	Percent
Total news	72	3.60%
Total spam	75	3.75%
Total self-promotion	117	5.85%
Total pointless babble	811	40.55%
Total conversational	751	37.55%
Total pass-along value	174	8.70%

Self-promotion usage was less than expected at 5.85% of all tweets. This may be enlightening to some, as there appears to be a flurry of companies and businesses joining Twitter to promote products and services. Business Twitter users appear to be well established national and multi-national firms.

A Twitter activity study conducted by Sysomos, Incorporated, a social media analytics company, indicated that 5% of the users contribute 75% of the tweets. This finding was based on indexing 11.5 million accounts, and then looking at the top 5% of users who accounted for the most

Tweets. Furthermore, they found that 32% of all tweets made by the most active Twitter users were generated by machine bots that posted more than 150 tweets/day. The most active Twitter machine bot users were operated by sources such as hotels offering deals, regional and national news services, regional weather services, the top news within Digg (a web site where users are news and information contributors), tags within Delicious (a social bookmarking website), and financial aggregators. These very active bots represented one-quarter of all tweets (Cheng & Evans, 2009). Though extensive in nature, the study did not indicate Twitter use by small businesses.

SOCIAL MEDIA: FREE OR FEE?

Although Twitter's current business model has yet to generate revenue, it is just a matter of time before this social networking application goes from free to fee for commercial users. Twitter's growth has attracted the attention of Internet blogs and news stories, and there are even social networking consulting businesses that offer expertise in online promotion of individuals and companies. Large businesses, like Starbucks (over 409,000 followers) and Apple (over 77,000 followers), are developing strong followings, but little evidence is shown of Twitter's value for the Mom and Pop shop.

To be more relevant to the business advertiser, Twitter has been making more acquisitions as it continues to grow, according to recent statements made by Twitter co-founder Biz Stone. To that end Twitter bought search engine *Summize* in 2008. Stone said Twitter will "start making money" through "non-traditional" advertising (Scheer, 2009).

Even with Twitter's textbook "hockey stick" version of a growth chart, there must be sustainability through user activity. "Such lofty plans may prove premature if Twitter can't find a way to maintain its popularity among users. Recently, traffic to Twitter.com has started to decline month over month" (Luechtefeld, 2009). A study by the Nielsen Company shows Twitter traffic dropped 27.8 % between September and October, bringing it down to 18.9 million unique visitors according to eMarketer. This is all the more reason Twitter must revamp its business model.

Small businesses are initially attracted to Twitter as a free advertising platform. However, at some point Twitter must generate a revenue stream. This might be accomplished through commercial-use fees based on the number of followers a business has or through user opt-in charges to access specific information tied to Twitter search features. These Twitter user fees could provide a rich environment for both Twitter and its business advertisers. The question then is this: Would the small business user be priced out of the market?

With the emergence of location-based applications via smartphones, other social networking sites may offer opportunities for small businesses to market through social media networks. Applications like FourSquare, Brightkite, and Google Latitude utilize GPS enabled smart phones to connect users. FourSquare, for example, allows users to "check-in" with other users through the GPS feature. Points are awarded to users who check-in from their location, say at a restaurant. These points can be used as a marketing tool by the restaurant that Foursquare users could exchange for goods. However, for these location-based applications to work, there must be a large user base, which has yet to develop.

COMMERCIAL USES

Developing a brand and user following on Twitter may be challenging for a small business, but it is free. The only resource needed is time. Because of the massive population that uses Twitter and the wealth of information and communicative power that it provides, small business owners should definitely explore its application to their business. Twitter does not just expose its users to what others are saying or doing, it has the power to introduce users to the entire World Wide Web. Tweeters post links to other websites, news articles, and blogs. Twitter allows its users to search locally, so small businesses in a single city can find people in the area, view their tweet activity, determine if they are potential customers, and follow them.

Searching for followers is not the only way small businesses can use Twitter, but caution should be exercised. Businesses contemplating using Twitter for public relations, customer service, or advertising should first apply due diligence to determine the practicality and feasibility for using social media, since the time investment required in managing a Twitter- based marketing program may not be cost effective. The small business entrepreneur should visit web sites and blogs of successful business tweeters and investigate their Twitter persona, because seeing the real thing is a more efficient use of time than reading articles about how to drive success using Twitter and other social networking sites (Comm, 2008).

If business owners are not using Twitter to follow customers or potential clients, they may be using Twitter for market research. Owners can determine what people are saying about their company or their competitors. As any entrepreneur knows, conducting market research before opening a business is essential. What is the current market lacking, and what do customers want? Is there an appropriate niche in the market for my idea? Twitter is a way to find out. Twitter tools like Internet surveys and search features allow ideas to be exchanged, followers to be acknowledged, and questions to be asked and answered.

Twitter can be used as a company account; or employees can be advocates, tweeting and promoting the business to their followers (Englander, 2008). The balance of power shift between companies and customers in today’s technologically driven business market has resulted in a new marketing paradigm. Social networking has allowed customers to interact with each other, share experiences with a company (whether good or bad), and create an image about which the company had no input. Customers are “defining their own perspective on companies and brands, a view that’s often at odds with the image a company wants to project” (Bernoff & Li, 2008). Some suggest that businesses need to take back the control of their branding, and one way to do that is by getting involved with social media themselves and monitoring what customers are saying about them. Twitter can be a tool that small businesses use to manage their online identity the same as larger companies. Otherwise, today’s social media savvy users may define your business first!

Small businesses have seen the benefits of using Twitter, and these success stories drive the idea that Twitter can be valuable for marketing. It can work, and it has worked. Success typically shows for a small business when loyal customers tweet about them. Subsequently, business owners have access to all of their followers who could be potential customers and clients. Success stories have been told about how Twitter has helped to double business clientele and interest, increase website traffic, and even drive sales. For instance, a local coffee shop in Houston, Texas, started taking pick-up orders through Twitter direct messages. This personal, immediate customer service is truly something a small business can offer. So by using that leverage and not simply tweeting about promotional offers, small businesses can capitalize on adding a personal touch and can use Twitter to do it (O'Grady, 2009).

First American Bank, Norman, Oklahoma, decided to use an unconventional approach, at least in the banking industry, to promote their bank, products, and events on Twitter. As one of the early adopting banks of social media marketing, First American Bank has seen an increase in "followers," as well as an increase in traffic to their website, promoting products and services via "tweets" on Twitter by using giveaways to attract customers (McAuley, 2009).

Mom and Pop shops have seen a few benefits, but the hypothesis is that this is not common. Larger organizations, like Comcast, Dell, and Southwest Airlines, use strategies that reach a larger audience and have greater results. Comcast, which delivers customer service through Twitter, made the headlines throughout 2009. The company employs half a dozen employees to talk to customers through the real-time site, answer their queries, and discuss any problems. Comcast currently boasts 35,470 followers on Twitter (Marshall, 2009).

According to Marshall (2009), in terms of how social media strategies translate into revenue, Dell announced in December that promoting its PCs using Twitter had generated more than $6.5 million in sales in 2009. Reports indicate there had been a 23% rise in the number of users following Dell on Twitter in a recent three-month period, resulting in 1.5 million followers. Other social strategies that have attracted public attention include Southwest Airlines, which employs a chief Twitter officer to alert flyers of bad weather and to monitor and respond to dissatisfied customers who use the Twitter site to complain.

METHODOLOGY

To get a representative, diverse sample from the small business community, a survey for small business owners was communicated to the target audience using two methods. First, the survey was sent to Small Business Development Center (SBDC) clients via email. SBDCs are programs within the U.S. Small Business Administration that provide free business start-up assistance and entrepreneurial development. The services provided by SBDCs nationwide include one-on-one counseling to nascent and expanding businesses as well as business training on a wide range of business and regulatory topics.

Clients who visit the SBDC for one-on-one counseling or for group training sessions provide their email address for future correspondence. This list of over 4,000 email addresses was used by the Tennessee Small Business Development Center (TSBDC) to reach a large audience of SBDC clients. SBDCs in Georgia, Iowa, and Kansas also participated by sending the survey to large client email lists and posting the survey link to their state SBDC website.

The survey was the primary method for gathering quantitative data from a large sample; but exploratory, qualitative research was conducted by using Twitter to investigate how it is used by the small business community. In addition to email requests, the survey was posted a total of seven times between the initial survey launch date and the closing date through the Tennessee Small Business Development Center's Twitter page. The survey was "tweeted" to an estimated 116 followers during different hours of the day to target different audiences. The Small Business Administration (SBA) also posted the survey to their followers two times to an audience of 3,160 followers. A third Twitter account was targeted, and the SBDC News twitter page posted the survey one time to 65 followers.

A second survey targeted business counselors at all Small Business Development Centers nationwide. Counselors at SBDCs provide a variety of services, including working one-on-one with current and prospective business owners and creating and administering training sessions. The purpose of the second survey was to provide insight into the other side of social media marketing and to determine how counselors communicate social networking marketing techniques to their clients.

Survey Design

Respondents were asked to answer survey questions via computer, and their confidential and anonymous responses were sent to a password-protected Internet database. Questions about basic demographics, small business type, Twitter use, and opinions about the value of social media marketing were included in the survey.

Survey A.

The design of the survey for small business owners filtered respondents to different sections of the survey based on their answers to certain questions. For example, respondents might answer "No" to the question, "Do you currently own (or work for) a small business?" In that case, they were directed to a set of questions at the end of the survey exploring their intentions to use social media marketing should they open a small business in the future. This survey design was used to ensure that the specific questions about their business were not answered by individuals who were not the intended audience.

Another filtering technique was used to assess the appropriate audience of Twitter users. Small business owners who indicated they did not use a Twitter account skipped the questions that specifically addressed Twitter and were directed to the end of the survey. To address specific users who use Twitter for marketing purposes, those who answered "Yes" to the item, "My Twitter account is for promoting/marketing my small business," were directed to a portion of the survey seeking opinions about Twitter's value as a marketing tool. The internet survey is accessible via the following link: http://www.surveymonkey.com/s/99X6QKS.

Survey B.

The survey for SBDC counselors did not use filtering techniques, and counselors answered all questions. The same Internet survey provider was used for this survey administration. Questions were asked about the location of a small business development center, their familiarity with social media websites, and the amount of encouragement given to clients to utilize social media for marketing. The Internet survey for SBDC counselors is accessible via the following link: http://www.surveymonkey.com/s/6CJLZGB.

FINDINGS

Survey A was directed to small business owners. Because the survey allowed for skipping questions, not all questions were answered by every respondent. The estimated sample size for Survey A is 694. The first question of the survey asked participants how they were contacted to complete the survey. This question was used to gauge how well the survey was communicated to the Twitter community and through e-mail. Of the 694 respondents, 6 were reached through Twitter; the remainder heard of the survey through email communication.

The survey design filtered respondents based on their answers to certain questions. Since 75 of the survey respondents did not currently own a small business, they were directed to a different set of questions assessing their intentions to use social media for marketing should they open a small business in the future. Of 607 small business owners who responded, 140 indicated they use a Twitter account. Those respondents were directed to questions that addressed Twitter marketing. Fully 93% of small business owners who responded had heard of Twitter, but only 23% were Twitter users.

Several demographic questions were asked. Most respondents (82%) were White; 15.5% were African-American. Hispanic and Asian individuals accounted for the remaining respondents. Gender was equally representative—slightly less than 50% of respondents were male. Over half of respondents were between the ages of 41 and 60 (See Table 2 for additional demographic information).

Table 2: Demographic Information by Percent		
Gender	Female	50.4
	Male	49.6
Race	White/Non-Hispanic	81.5
	African-American	15.5
	Hispanic or Latino	1.9
	Asian	0.9
Age	21-30	9.8
	31-40	19.5
	41-50	29.1
	51-60	28.9
	60+	12.4
N = 685		

Of the 624 respondents who stated that they currently own or work for a small business, 46% of the businesses were relatively new, open from less than 6 months to 2 years; and 69% of those surveyed indicated that the gross revenue/sales of their most recent business year was less than $250,000. A diverse representation of business types was collected. Businesses in service (such as retail, food, professional, scientific, and technical), manufacturing, entertainment, construction, and many others were represented in the sample. Sixty-six percent of small business owners surveyed said they conduct business online for a variety of purposes, including sales, advertising, and marketing.

Twitter Information

Although 93% of the 600 small-business owners surveyed had heard of Twitter as a social networking site, only 23% use a Twitter account at all, reducing the sample size for the remainder of the survey to 140 Twitter users. Specific questions about Twitter usage provided information about frequency and time devoted to using Twitter. When asked how long they had a Twitter account, 41% said for only 1-6 months, and 45% had a Twitter account for over 7 months to 2 years. The majority of respondents (77%) were occasional or rare tweeters, posting mini-blog messages on their Twitter page monthly or weekly. Over half of the respondents follow between 1-50 other Twitter users and have 1-50 followers; 38% have between 51 and 500 followers.

Next, the survey explored the purposes of using Twitter by small business owners (See Table 3). The most frequent use (78.5%) of Twitter by the small business owners was for marketing and promotion. The second and third most frequent uses of Twitter were for business networking (76.5%) and social networking (59%).

Table 3: Twitter Usage by Small Business Owners	
Purpose	Percentage of Use
Small business marketing/promotion	78.5
Business networking	76.5
Social networking with friends	59.0
Keeping up with industry news	55.2
Looking up products or services	37.6
Keeping up to date with hobbies/interests	37.4
N = 141	

Of the 135 Twitter users, 106 said they used Twitter for small business marketing. Those who used Twitter were directed to answer questions regarding the value they see in using Twitter for marketing (See Table 4 for a summary of opinions about Twitter's value as a marketing tool).

Table 4: Twitter as a Marketing Tool	
Statement	Average
Twitter is a valuable marketing tool for my small business	3.6
Using Twitter helped people in the community know more about my business	3.3
Since using Twitter, I have seen an increase in interest in my business	3.3
I have seen an increase in traffic to my business website since using Twitter	3.3
Marketing with Twitter has increased the customer base of my small business	3.0
Twitter marketing has helped increase business revenue	2.8
I have seen an increase in customer satisfaction since using Twitter	2.8
I have seen an increase in repeat business since using Twitter	2.7
N = 94 Note: 1 = Strongly Disagree, 2 = Disagree, 3 = Neutral/Undecided, 4 = Agree, 5 = Strongly Agree	

Table 5 details several specific Twitter marketing strategies. Survey responses suggest that small business owners are not yet using Twitter extensively in marketing their products or services.

Table 5: Use of Specific Twitter Marketing Strategies	
Statement	Average
I tweet about promotional opportunities on my Twitter business page	2.9
I use Twitter to monitor what other Twitter users are saying about my small business	2.5
I respond to questions my followers ask about my small business	2.2
N = 92 Note: 1 = Never, 2 = Seldom, 3 = Sometimes, 4 = Often, 5 = Almost Always	

Respondents were asked their opinion of brand Twitter pages or Twitter pages written by a company or business. Fifty-two percent said Twitter pages were an interesting way to gain insight into business, and 39% said it was a good way to keep up to date with the company. As for other social networking sites, 85% of Twitter users also use Facebook to market their small business; only 21% of them use MySpace. Many (59%) Twitter users also used LinkedIn for marketing.

Non-Business Owners

The survey design allowed participants to skip questions that did not pertain to them. Respondents who did not own or work for a small business were directed to questions addressing their intentions to use social media. Of those who answered, 85% were interested in starting their own business. Sixty-five percent indicated agreement with the statement, "Social media is a valuable tool to research the business market." Sample respondents also indicated intentions to use social networking sites to market their small business should they open one ($\mu = 3.9$). Non-business owners were asked to indicate what other social networking sites they use, and 38% said none. Over half (56%) use Facebook and 35% use LinkdIn.

Small Business Development Center Counselors

Survey B was sent to a representative sample (n = 184) of SBDC Counselors from each region of the U.S. The largest segment of the sample was from the South (35%) followed by the Midwest (34%). The remaining counselors (32%) were located in the Northeast and Western U.S.

Familiarity with Social Media.

Counselors were asked about their familiarity with three popular social networking websites: Twitter, Facebook, and LinkedIn. On a 5-point scale where 1 = not at all familiar and 5 = extremely familiar, counselors were least familiar with Twitter ($\mu = 2.8$) and were slightly to moderately familiar with how Twitter can be used for small business marketing ($\mu = 2.7$). Participants were most familiar with Facebook in general ($\mu = 3.4$) and moderately familiar with Linkedin ($\mu = 3.0$).

Encouragement of Social Media Use.

Counselors were also asked to indicate the amount of encouragement they give to clients to utilize social media, particularly for marketing. On a 5-point scale where 1 = never and 5 = almost always, counselors indicated that they sometimes encourage business clients to utilize social media for marketing and sometimes discuss how to use social networking websites with clients, $\mu = 3.4$ and $\mu = 3.1$, respectively. Counselors indicated that sometimes their clients are interested in learning how to use social networking websites for business purposes ($\mu = 3.2$). Regarding encouraging potential business owners to conduct market research using social networking sites, the counselors responded seldom to sometimes ($\mu = 2.7$).

CONCLUSION

Social media provide opportunities for entrepreneurs, but they also present unique challenges for small business marketing. Is Twittering expected? If a business does not "tweet," is it shrugged off or not taken seriously? Not having a Twitter account may send a message; but an inactive, dead Twitter blog sends a different kind of message. When small business owners start a Twitter account, they have a responsibility to monitor it and develop a solid following and do so without the human capital, infrastructure, and financial capacity available to large companies engaged in a social media marketing campaign. An inactive Twitter account with dwindling followers and unanswered customer messages would obviously be contrary to a business's social media marketing objectives and one reason why small business owners are not embracing Twitter as a marketing tool.

A Citibank/GfK Roper survey conducted in October 2009 suggested that small business owners are not widely using websites like Twitter and Facebook as much as the media suggest. The survey found that 76 percent of small business owners did not use social media and did not find them helpful in generating business leads. Eighty-six percent did not use social media sites to get advice or other information (*Baltimore Business Journal*, 2009). The Executive Vice President of Citibank's Small Business Segment suggests, ". . .many small businesses may not have the manpower or the time required to take advantage" of the opportunities social media can provide to help network and grow a business.

The current study supports Citibank's findings, also suggesting that small business owners are not using Twitter. Minimal Twitter use in the small business community cannot be attributed to a lack of knowledge since 93% of small business owners surveyed have heard of Twitter. However, only 23% use a Twitter account at all. Although the most frequent use of Twitter by small business owners (135 people) was for marketing and promotion of their small business, this number is small in comparison to the number (607) of small business owners initially surveyed. Interestingly, when small business owners were asked in general if they believed Twitter was a valuable marketing tool for their business, the average response was undecided. For the more specific questions about

Twitter's value as a marketing tool, the majority suggests that it is undecided and leaning toward slight disagreement that it added any value to their marketing efforts.

When the small audience that used Twitter for marketing was asked specific questions about Twitter marketing strategies, including tweeting promotional opportunities, monitoring what others are saying about their business, and responding to questions that followers ask about their small business, most respondents indicated they seldom use these strategies at all. Could this be why they are not seeing value in using Twitter? Small Business Development Center counselors are moderately familiar with social media but only sometimes discuss using them with clients for business purposes or as a way to conduct market research. This connection between the two surveys demonstrates that not only are small business counselors not informing owners about how to use Twitter effectively, but small business owners are not using the strategies that Twitter marketing bloggers and consultants suggest.

Small businesses will expend more time and effort in developing a brand on Twitter than will brands like M&M, whose Twitter persona is the recognizable green M&M, or Coca-Cola, with its signature logo that is one of the world's most recognizable commercial brands. So how can small businesses capitalize on the social media trend? They need to be informed about how to use it effectively and manage their time with the social networks that offer the most return. However, the majority of small businesses will have difficulty justifying the time investment and expense associated with self-promotion using Twitter. Those small businesses currently using Twitter are for the most part engaging in loss leader marketing where goods or services are priced at a loss and widely advertised through social media in hopes this method of promotion will draw new or returning trade to the business. This cost of promotion is too time consuming for most entrepreneurs because Twitter followers must be cultivated to ensure they stay engaged.

Advertising through social media has not matured to the point of either reliability or the predictability of the targeted audience responses. That inability to quantitatively measure a return on investment drives most small business owners away from using or continuing to use a marketing strategy that yields no solid indication of success for the substantial commitment of time and money required. Further research will be conducted if and when Twitter and other social media venues are able to develop a commercial user structure that enables users to calculate their return on investment.

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USING SOCIAL MEDIA TO INCREASE ADVERTISING AND IMPROVE MARKETING

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ABSTRACT

This paper will focus on explaining why entrepreneurs, other practitioners, and faculty must understand the effects that the proper use of social media has on the success of businesses. There is a crisis in mass marketing which must be addressed. With the economy in its current condition, it is imperative that entrepreneurs also understand how to use social media to increase advertising and improve marketing. The traditional marketing model is being challenged, and how to generate leads, increase awareness, and ways of communicating are continually evolving. This paper will discuss the advantages and drawbacks of using social media and will answer questions relevant to the use of social media.

INTRODUCTION

With the introduction of the World Wide Web in 1989, the internet became a global network. Since that time, also known as the Information Age, the amount of content available has changed drastically, and the use of Social Media has planed an important role. There are many definitions of Social Media, but one by Ward (2010), that appears to adequately describe the phenomenon states, " Social media is a type of online media that expedites conversation as opposed to traditional media, which delivers content but doesn't allow readers/viewers/listeners to participate in the creation or development of the content." There is a wide variety of social media, ranging from social sharing sites such as YouTube and Flickr through social networks such as LinkedIn and Facebook.

Social media also appears to be a driving force in the Attention Age (Attention Age, n.d.), which appears to have gained steam after the Information Age (also known as the Computer Age or Information Era). The Attention Age, which began in the first years of the 21st century, is relevant because it has given individuals the ability to create and consume information immediately and distribute it on the Internet. In the Information Age, however, Google and Bing play a lesser role then they did in the Information Age. This is because the Attention Age appears to more user-friendly and focused than Google and Bing.

In addition, Social media is important because it permits users to instantly obtain and share information. Social media avenues such as Facebook, MySpace, and YouTube, permits users to share content with friends, and Blogs, which are user created, permits individuals to also share information. Sites such as del.icio.us and Digg also permit users to organize and share content, and Twitter has become known for its ability to break news before the news even reaches traditional media outlets. Additional forms of social media include internet forums, wikis, podcasts, instant messaging, music-sharing, and voice over IP.

REVIEW OF THE LITERATURE

The potential usage of social media in the near future or even today is tremendous (Savage, 2010). As Savage (2010) indicated, the enormous volume of data provided by social media will provide both new challenges and new opportunities. Social media is already effective, but Savage predicted that once different types of social media recognize what is needed, the actual search engine time could be reduced from hours to minutes. Susan Dumais, a researcher for Microsoft, pointed out that the large amount of volume on the Web is very beneficial for some types of algorithms (Savage, 2010).

Being knowledgeable of the value derived from social commerce networks is very important, especially since both social shopping communities and social commerce are increasing in size (Stephen and Toubia, 2010). Stephen and Toubia (2010) found that the sellers who benefit most from a network are those who gain the most accessibility by using the network. Understanding work-of-mouth marketing in online communities is also important (Kozinets et al, (2010). Kozinets and others (2010) explained that word-of-mouth marketing, which is influenced by consumer-to-consumer spending, has encompassed social media and viral marketing techniques.

Information managers also cannot afford to ignore the effect or impact that social media has upon their day-to-day activities (Barnes and Barnes, (2009). By becoming more award and knowledgeable of the impact of social media, it is possible for managers to become a more effective collaborator and educated decision maker. Barnes (20090 also stressed that social networking in continually evolving in functionality and that it is only a matter of time before new features such as Internet phone services and video conferencing further increase the capabilities of the social media platforms.

As an article by Patton (2009) indicated, social media is here to stay. His article, which analyzed industry trends, also reiterated that training professionals must understand the importance of social media in the workplace. Patton (2009) stated it well when he wrote, "social media presents tremendous opportunities for networking, collaborating, sharing best practices, communicating and connecting to a nearly unlimited pool of people with similar needs and wants."

Social media is also very important in the marketing area (Luke, 2009). The article by Luke (2009) found that 60 percent of planners averaging at least 16 online leads per year use social media. Luke's 2009 article pointed out that Facebook is the perfect forum for financial planners with large social networks or clients who are the type to use Facebook. LinkedIn, which was designed solely for business professionals, also provides an opportunity for parties to connect with centers of influence (Luke, 2009).

In addition to Facebook, blogging is now one of the most widely used networking and social media tools (Thevenot, 2007). We are now definitely in the social media era, and the use of blogging is continually increasing because feel that they are actively engaged in a conversation. From a marketing aspect, blogging is also beneficial. As an example, the CEO of the Marriott Corporation regularly posts comments relevant to the firm, and he even answers comments posted by visitors to the site (Thevenot, 2007). There is, however, a corporate social responsibility when blobs are used (Fiesler et al, 2010). Companies must make a sincere effort to make sure that their stakeholders know their corporate social responsibilities (Fiesler et al, 2010).

Clapperton (2010), however, reminded his readers that they can not take social media for granted. The use of social media will probably increase, but there is no guarantee that it will. In the 1990's, the use of social media as a remote working tool was seen as the immediate wave of the future. It's now 2010, and some firms use of social media as a remote working took simply did not work because employees didn't like the remote working environment. Generation Y individuals (those born from 1977 – 1998) appear to be the most likely to expect that records and information should be available instantly (Simons, 2010).

On-line communities, an integral part of social media, are beneficial because they provide cross-selling opportunities to different user group who share the same platform (Hodge, 2010). Social media platforms can provide immediately feedback and give firms a quick indication of what is needed to solve pertinent issues (Hodge, 2010). Hodge (2010) also noted that more and more firms are determining means to use social networking sites. Linkedin, for example, is being used by Human Resource find suitable candidates for a position. As another example, glassdoor.com, which permits employees to post reviews of their workplace, is being used for recruitment and retention benchmarks by businesses (Hodge, 2010).

The Hodge article explained that social networking sites permit companies to involve customers in the innovation process. A by-product of this would be the possible reduction in R & D costs.

Social media is also having an effect on college students. Students can now go to GradeGuru.com and obtain papers, study guides and class notes (Cohern 2010). The article points out that Cliff notes and other printed material are still available and will never go out of fashion, but the GradeGuru.com site will give students an additional option.

QUESTIONS THAT NEED TO BE ASKED

When developing a social media strategy, you must determine (a) who the customers are and what they do, (b) does the information that a firm can provide to the customers mean anything, and (c) is it valuable. You also need to make sure that your social media avenue being used abides by the law, and you need to ask for whom your social media presentation is being developed. What is your target market relevant to age, sex, ethnicity, culture, etc. Knowing the responses to the questions stated below should give you some insights into the cost of developing, implementing, and effectively using your your social media strategy.

Why is social media useful or important in marketing?

As Swedowsky (2009) stated, businesses can not afford to ignore the benefits of using social media. In the past, consumers often just had the opinions of a few friends before making a significant purchase. The use of social media can increase of the number of those opinions from just a few to hundreds or even thousands (Swedowsky, 2009). Buchwalter (2009) reiterated that social media continues to abound for both businesses and the consumer. As Buchwalter stated, online access is no longer a luxury, it is a necessity.

Businesses have also realized that consumers use social media because it is fun. They can easily share their ideas, photos, videos, likes and dislikes with each other. Businesses realize that importance of having increased interaction with consumers and retailers, and the use of social media gives them the opportunity to more efficiently meet the demand of their customers.

Many firms now use social media to enhance their marketing scheme. Health care and pharmaceutical firms have been slower to react because of regulatory concerns, but even they are now regularly using social media to communicate with patients and physicians. Other firms also use social media for promotions and to survey groups for records of past purchases and interests. One has to be careful, however, when reading the reviews of any firm on a social media outlet. It is easy for a firm to put a fake review of a product on a social media outlet to enhance the probability that a consumer will purchase that product.

What is the purpose of social media?

The purpose of social media should be to enhance a business' branding and permit their biggest fans (i.e., super fans) to just talk about them. Businesses just need to help facilitating the discussion. Social media should also be used to track a business presence online, to make sure that clients are no degrading the branding value.

Ward (2009) stated that one of the purposes of social media is to find out more about what customers are thinking. Businesses must also use social media to sell their products or services (Ward, 2009).

What are the keys to developing better social media strategies?

Use traditional marketing in conjunction with the use of social media. Finance your marketing. Combine the use of PR, marketing and social media. Do not separate these departments.

It would be wise to form cross sectional teams to assist in the use of these strategies. Think of yourself. Also, what things would you like to read and do. Think like a customer and not like a marketer.

Chris Brogan (2008) stated that the key is to use better time management. He felt that there were two key functions, having a simple system and automating everything possible. Brogan's (2008) article stressed that use of the key functions would permit more time to do the things that are the most important.

What percentage of the time should social media be used?

Some books suggest no more than one hour a day, but several corporations have devoted entire departments to doing nothing but social media. Basically, it should be used to the point where it is no longer effectively increasing profitability. This means that it should be used to increase customer satisfaction with the specific media used by them and should be used to increase market share.

Firms must also be cognizant of social media clutter and realize that overexposure might have some negative consequences (Brauner, 2009). Black Friday deals may end up overloading websites, and, as a consequence, some individuals who might have wanted to shop for their regular deals (and the one most profitable to the company) would not have been able to do so because of purchases being made of sale items during peak hours of usage by consumers. One possible strategy that must be considered is that businesses should offer "deals" during slow purchase times, which would generate a level flow of traffic to the website. All firms must thus also consider bandwidth capability when offering deals.

Does the effectiveness of the use of social media decrease over time?

The answer to this question depends on the continuality of its use. If you start and stop, then yes. If you start social media and continue to use it on a regular basis, it should only increase. You will have an increased viewership and engaged customer group. It all comes down to the value you provide your customer base who are engaged in social media.

One must be concerned, though, of the effect that one means of social media can have on another (Lukovitz, 2008). As Lukovitz (2008) indicated, the use of texting and cell phone communication is beginning to negatively effect permission-based marketing. However, Jon Gibs, VP of Media Analytics (Gibs, 2009), disagreed with Lukovitz. His research indicated that the amount of e-mail sent by high social media consumers actually increased as additional social connections are made. In Gibs (2009) opinion, the newer and more convenient technologies do appear to affect the effectiveness of one social media over another.

As an example, an analysis of one YouTube video (Skul, 2007) indicated that the person making the video has drawn more attention overtime as the number of viewers has increased dramatically. If the information is useful, it appears that the effectiveness of the social media outlet being used will not decrease over time. However, if the content is only applicable for a once or very few times use, it may be necessary to have diversified or varied types of social media to enhance the "stickiness" factor. Various strategies must be adopted to keep consumers loyal to brands, products, and services via social media. In other words, the effectiveness of social media might not increase or decrease over time, depending on how well a person or entity handles the current use of social media to keep the consumers interested.

John Lewis, President of Consumer North America, pointed out that the increased use of social media has permitted firms to more efficiently outreach, and that firms should use social media increasingly, insuring the even distribution of the three major advertising avenue – TV, Mobile, Internet ((Garcia, 2009).

How should one go about developing an effective social media marketing campaign?

This depends on your company and your customers. If you truly segment and understand your customers, it will make sense. Sometimes, luck is involved when finding well known social media strategies to assist you.

An article by Liana Evans (2009) stated that by 2010, 60% of the Fortune 1000 Companies would be involved in some form of social media advertising. According to Evans article, half of the companies will fail. Evans (2009) questions what will happen to small businesses, if only 50% of the Fortune 1000 companies are successful. She does state, however, that small firms have some competitive advantages because of less red tape to deal with which to deal.

Evans (2009) said that firms should follow the sequence below when developing an effective media marketing campaign.

1. Identify your audience
2. Define your success measurements
3. Plan a Strategy that Includes All Stakeholders
4. Be transparent
5. Recognize that it's not about you

What is the best way to use social media in an effective marketing campaign?

It depends on the situation, but as Gibs (2009) indicated, social media is the next great gateway for content discovery. Facebook and other message boards and blogging sites are becoming important when consumers seek product information. Facebook traffic has increased over 200% in the past year and Twitter traffic has increased over 1500% (Swedowsky, 2009). Just posting on search engines information about a product that a person/entity to promote should not be the only option. The product or service should also be promoted on other social media outlets.

Knowing the target audience for the product to be promoted is very important and should probably be the first step in designing an effective marketing campaign. For example, if a promotion is designed for a rural area where high speed internet is not available yet, a satellite internet company might find TV or other mediums of communication more beneficial for promotion of its product that social networks.

What are the benefits and drawbacks of using social media?

It is completely dependent upon your company and what you post. Also, if your quality is not of the highest level, it is likely to be discussed more when using social media.

There are both advantages and disadvantages to using social media. Advantages would include the ease of obtaining data input from media users via the internet or computer based automated applications without having to manually sort through the data. Although the initial process of developing a customized applications/process can be costly and time consuming, it will pay off over time because of the valuable information that marketers can use to target specific market areas. Data obtained might include age, gender, zip code, money spent, material purchases, and other details of information relevant to the market content that is desired.

Das (2009) gave some advantages of social media. Among them were low costs, builds credibility, and the increased number of connections. Some of the advantages relevant to business cited by Mercer (2009) included making it easier to form a new business, enhance an existing business, enhance selling merchandise, receive employment recommendations, and receive employment recommendations.

Disadvantages would include, from a marketer's viewpoint, safety concerns, especially those applicable to Internet privacy and security issues. Marketers might also be concerned about spending significant amounts of capital to give assurance (building trust) to media users to assure that the users than any information obtained from them will not be misused. Examples would include sites as the dating site, match.com, or social sites such as facebook.com Additional disadvantages might include concerns relevant to who is watching the sites, such as employers, parents, or individuals who the users of the site would prefer not have access to the information. Disadvantages mentioned by Das included lack of anonymity, scams and harassment, and time consuming. Another disadvantage might include the possible bias of opinions shown on social media sites. A careful analysis of the material being presented is important, but this is cumbersome at times.

An article by Dube and White (n.d.) listed some additional areas where social networks might be harmful to society. The article stated that surveys indicated a huge amount of teen use of social networks. Doing this often leads to the teens depending on the social networks to maintain friendships. Dube and White (n.d.) also indicated that too much dependence on social networks can lead to poor interpersonal communication.

What developing a social media strategy, what specific questions should you ask?

As was stated in the Abstract of the paper, when developing a social media strategy, one must determine who the customers are and what they do, does the information you can provide to them mean anything, is it valuable. If your customers do not care, why should you? You also need to make sure that your social media avenue being used abides by the law. You need to ask for whom your social media presentation is being developed. What is your target market relevant to age, sex, ethnicity, culture, etc. In addition, you need to determine the cost of the social media strategy being used and make sure that the benefits will outweigh the cost to the company.

An excellent article by Falls (2009), said that the following questions must be asked.

> "What types of people do we want to talk to?"
> "Where do we find them?"
> "What are they talking about already?"
> "Is it appropriate for us to join that conversation and, if so, when?"
> "How do we inject usefulness into the conversation without being overly promotional?"
> " What value can we provide in terms of knowledge, opinion or content?"
> "How can we earn their trust?"
> "When we do earn their trust, how can we best ask for their input into our product or service?"
> "Under what circumstances can we point the conversation toward considering our product?"
> "Can we say or do something that invites someone else to point the conversation toward considering our product?"
> "How shall we apologize and regroup if we overstep their comfort level or accuse us of violating their trust?" (Falls, 2009)

LaChapelle (2009) gave ten questions to ask when developing a social media strategy. Her questions were similar to those of Falls (2009), but one of her important questions was, "Do we have the resources to keep this up or will this be a short campaign?

What are others saying about the use of social media?

It all depends on your school of thought. You have to believe it can work and have organizational buy-in for social media to succeed. To the people that achieve success, they love it. It should be noted that the U.S. Census Bureau has already begun using a blog by the director that gives updates on the nationwide census efforts (US Census Bureau, 2009). In addition, Census 2010 has a "Rapid Response" plan that will incorporate attitudinal tracking, field intelligence, and social monitoring.

There are different forms of social media, and all of them function in different ways and have strategic plans with an emphasis on different groups of people (Laurent, 2009). Laurent's article (Laurent, 2009), which focused on social media in health care, noted that over 50% of the social media users used the search engines to obtain information relevant to health care needs.

What is the simplest way to use social media?

Brauner (2009) gave eight simple ways to alleviate social media clutter. Stated verbatim below, they are:

1. Build a large web presence
2. Leverage multiple traffic sources
3. Develop relationships
4. Offer many ways for friends to subscribe or follow
5. Be reliable and consistent
6. Promote others
7. Focus
8. Collaborate

How should social media appeal to its' audience emotions? What must be known about audience to whom the social media techniques are being used?

Everything. This is the key to marketing. Belcher (2009), in a 2009 video, explained that social must satisfy the needs and wants of its customer. One of its goals should thus be to increase customer satisfaction. You must know your customers. As an example, McDonald's Big Macs would not sell in India because the majority of Indians, who are Hindu, do not eat beef. Attempting to sell Big Macs would thus have a negative effect because of the Hindu beliefs. Knowing this, McDonald's developed a veggie burger that sells very well in India. In addition, since many Indians prefer delivery, McDonald's has begun a delivery service in many regions of India.

SUMMARY AND REFLECTION

It is obvious that the use of social media to enhance marketing is here to stay, so one must consider all possible avenues to positively use it to increase advertising and improve marketing. It is also obvious that there are benefits, drawbacks, and challenges associated with any social media strategy, and these must be addressed before a specific social media strategy is implemented. The purpose of social media should be to enhance a business' branding and permit their biggest fans (i.e., super fans) to just talk about them. Businesses need to assist in facilitating the social media inputs and discussions. In addition, social media strategies should also be used to track a business presence online, and to make sure that clients are not degrading the branding value.

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HOW A BETTER BUSINESS BUREAU (BBB) CAN HELP BBB ACCREDITED SMALL BUSINESS MEMBERS

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ABSTRACT

Better Business Bureaus (BBB) date back to 1912 when they were established to correct abuses in advertising. It was also the beginning of the concept of volunteer self regulation in the marketplace without the intervention of local, state, or federal government. The modern day BBB is recognized for services provided for consumers. This paper examines how the BBB can help BBB Accredited Business small business members. Ways of helping include reports on prospective vendors, arbitration with consumers, and help in complaint analysis to improve operations. Perhaps the most valuable help is identifying members as Accredited BBB members. Accreditation status provides a greater likelihood that consumers will buy from that business. A key to success is using the BBB logos to inform the public that one's business is a BBB Accredited business.

INTRODUCTION

The origin of the Better Business Bureau (BBB) dates back to 1912 when "Vigilance Committees" of Advertising Clubs were established to correct abuses in advertising. The BBB's original function has broadened to monitor other activities in the marketplace and business performance. Today there are 137 Better Business Bureaus in the United States. (Council of Better Business Bureaus, n.d.). BBB Accredited Businesses are companies that meet the standards for accreditation. Funding to support programs, activities, and staff is provided by member dues

The BBB provides many services for the consumer. Yet, the Bureau provides useful services to its members. The purpose of this paper is to illustrate how a BBB Accredited member small business owner can use the services of the Bureau to benefit the firm and contribute to its profitability.

BBB SERVICES TO CONSUMERS

First let us consider some of the services the BBB provides for consumers. The BBB collects and reports information to help prospective buyers make informed buying decisions. Specifically, the BBB develops reports about companies. These are reports available to the public and are intended to provide an informative, accurate, and unbiased summary about the business. BBB reports are available to the public by telephone, in writing, and the BBB's website. The reports are neutral as the agency does not recommend businesses (BOC Bureau Operations, 2007).

Bureau websites offer online resources, educational tools for consumers, and video content. Each BBB offers a specific assortment of educational resources tailored to the needs of the area. For example, one BBB executive director speaks to business students at local colleges about the services of the BBB.

The BBB helps consumers indirectly by monitoring advertising and selling practices and seeking corrections and improvements where appropriate, providing consumer information to news media such as radio, television, and other print media, and alerting consumers about fraudulent and harmful practices in the local community and cooperating with appropriate law enforcement agencies. (Council of Better Business Bureaus, n.d.)

The BBB can help resolve buyer/seller complaints against businesses by means of conciliation, mediation, or arbitration. Conciliation is conducted by the BBB staff. Mediation occurs with a professionally trained mediator who works with both parties guides them to working out a mutually agreed solution. Arbitration is an informal process in which a neutral third party decides the dispute. (Council of Better Business Bureaus, 2003).

HOW THE SERVICES OF THE BBB CAN HELP THE SMALL BUSINESS OWNER (BBB ACCREDITED MEMBER)

Consumers can check with the BBB about prospective sellers. Small business owners can do the same. Young (1994) found that 81 percent of the BBB members surveyed used the BBB to check the reliability of unknown companies before doing business with them. Also, 80 percent of members called on the BBB to check out charitable organizations before they made a contribution or donation. Some 68 percent belonged to the BBB because the BBB warned members of scams (Young, 1994).

Arbitration is one way a marketplace dispute between a BBB member and a customer may be resolved. Young (1994) found that 28 percent of BBB members belonged to a BBB because of the opportunity for complaint resolution. The BBB provides at no charge to the Accredited member or consumer a professionally trained arbitrator who will listen to both sides, weigh the evidence and make a decision about the dispute. Most of the BBB arbitrators are attorneys who volunteer their time to do arbitrations.

The decision may order an action to be performed, money to be paid, or a combination of those remedies. The arbitrator may award all or part of what is sought or may decide to award no payment or performance at all. Decisions may be final or interim. If a final decision is given, the arbitrator has no further authority over the decision unless a valid request is made pursuant to certain rules. An interim decision may be written when the decision requires that some action be taken (Council of Better Business Bureaus, 2003). Arbitration offers several advantages to the BBB member who uses it. Legal actions by the customer may be eliminated. In addition, there are no court or attorney's fees. The entire process takes only thirty days or less.

Total Quality Management (TQM) is a philosophy of management which suggests that a business can improve its business operations and its relationship with its customers. Customer complaints, comments, and telephone calls suggest internal problems resulting in poor products and/or service (Young, 1994). The next step is to investigate the reasons for those complaints and then to correct the problems in the quality of product or service. For example, complaints about late deliveries may be due to new drivers who are not familiar with the area or poor scheduling of deliveries.

ACCREDITATION: A NEW BEGINNING

The Council of Better Business Bureaus has implemented a new BBB rating system, one which uses an A plus through F letter grade scale. Previously, the BBB awarded member businesses either a "satisfactory" or "unsatisfactory" grade which did not provide as much insight as a letter grade.

The rating system relies on a proprietary formula that takes into account 16 factors based on objective data and actual incidences of a business's behavior that has been verified and evaluated by BBB professionals. Factors include such items as the type of business and its business model, how long the business has been operating, total volume of complaints filed against the business, an overall complaint analysis, and government actions against the business. Businesses are awarded points based on the 16 factors which are weighted according to the BBB's assessment of the importance of each factor. The points are calculated using a formula and a letter grade is awarded on the point range the businesses fall into. Complaint history drives a business's letter grade score. A business must have and maintain a B or higher grade to remain a BBB accredited business. (Council of Better Business Bureaus, 2008).

Accreditation in the BBB is important to the small business owner. It means more business or sales. The findings of a survey conducted by Princeton Survey Research Associates International found that seven in ten consumers indicated that knowing a firm is a BBB Accredited business makes them more likely to do business with it. (Princeton Survey Research, 2007).

Today's consumers want confidence in their buying decisions. Evaluating trustworthiness of a business is one of the first steps in making a purchase. The BBB's Start with Trust promotion campaign points out to the consumer that there are measurable and accountable standards of trust. Those Standards of Trust are: Build Trust, advertise honestly, tell the truth, be transparent, honor promises, be responsive, safeguard privacy, and embody integrity.

BBB accredited members are provided with a new logo and tagline. Also, the BBB website has been redesigned. There is a consistent nationwide look and feel. Faster and more direct access to information is available through a new global site search process. Instant update features will push information to users when and where they want it, to help consumers find BBB accredited businesses quickly and easily (Council of Better Business Bureaus, BBB Brand, n.d.).

Accredited members may use the BBB Accredited Business Seal in promotion. They may advertise using the Accredited Business Seal in all media allowed under the program. The member is encouraged to use the seal in newspaper ads, on television, fliers, etc. A variation of the BBB seal is available for use in yellow page/directory advertising only. There is also a special seal and program for a business to advertised BBB Accreditation on their website.

The BBB Wise Give Alliance (www.give.org) helps business and consumers make informed decisions and advances high standards of conduct among organizations that solicit contributions from the public. There are 20 "Standards for Charity Accountability" that are applied when the Alliance reviews a charity.

The BBB Wise Giving Alliance produces reports on nationally soliciting charitable organizations. The Alliance does not rank charities but rather seeks to assist donors in making informed judgments about charities soliciting their support.

CONCLUSION

BBB services to Accredited member firms include the opportunity to evaluate prospective vendors. No-cost arbitration services and the opportunity to analyze complaints to determine weaknesses in internal operations are benefits.

Perhaps the most valuable aid to helping the BBB members is the Accreditation program. Today, consumers want trust in the businesses they are buying from. For over 100 years the consumer and businesses have recognized the BBB as the "go to" organization for marketplace trust issues. The Accreditation program is a new way of providing that trust. Some 70 percent of consumers say they will buy from a BBB Accredited company. Similarly, a study by the Shapiro Group (2007) found that when a small business is a member of a local chamber of commerce, some 63 percent of the respondents said they are more likely to purchase goods or services from that business in the future. The key here is for the BBB member to make customers and potential customers aware of his/her being an Accredited BBB member. A plaque in the front of the store or use of the logos provided by the BBB national office are ways to promote one's Accreditation.

To maintain its BBB Accreditation status small business management must maintain a high standard of quality product and service. Stress must be put upon the proper hiring, training, motivation, and evaluation of employees. Quality control must be emphasized in the production of goods and services.

Trust in the buyer-seller relationship is more important than ever in the marketplace. The BBB's Accredited Business Market seal is an indication of that trust, and potential sales for the BBB Accredited member.

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THE TAX PREPARER PENALTY PROVISIONS OF IRC §6694(A): SOME REFLECTIONS ON THE POSITIVE AND NEGATIVE IMPLICATIONS FOR TAX PRACTICE

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ABSTRACT

Originally motivated by Congress' belief in widespread abusive practices by income tax preparers, as well as concerns that significant numbers of fraudulent returns were being prepared by income tax preparers, the tax preparer penalties of §6694 were enacted in 1976. The original intent was to curb abusive tax practices. Since their original enactment in 1976, the §6694 tax preparer penalty provisions have undergone 3 substantive revisions by Congress (1989, 2007, and 2008). The intent of the revisions was to increase the amount of the penalties and the types of tax work subject to the penalties and to decrease the range of ambiguity in which tax professionals may legally operate. In this environment, it becomes critical that tax practitioners be conversant with the complex expectations under which they must operate. This article discusses some of these recent changes and how the tax profession might best manage these changes.

INTRODUCTION

Originally motivated by Congress' belief in widespread abusive practices by income tax preparers, as well as concerns that significant numbers of fraudulent returns were being prepared by income tax preparers, the tax preparer penalties of §6694 were enacted in 1976. The original intent was to curb abusive tax practices. Since their original enactment in 1976, the §6694 tax preparer penalty provisions have undergone 3 substantive revisions by Congress (1989, 2007, and 2008).

In the first of these revisions (1989), the tax preparer penalty provision (in particular the §6694(a) penalty) was redirected, expanded in scope, and increased in magnitude. The provision was redirected away from "the negligent or intentional disregard of rules and regulations" and refocused on reducing the range of ambiguity within which tax preparers could legally operate.[1] A certainty threshold criterion approach was enacted in an attempt to accomplish this purpose. The new standard of tax practice under §6694(a) now became "the realistic possibility standard." Following passage of the 1989 revision by Congress, the IRS promulgated Regulations to interpret and enforce the new law, including an attempt to quantify the realistic possibility standard in terms of odds of winning a dispute with the IRS or the courts.

In 2007 the second revision of the standard made substantive changes in terms of both the scope of the provision and its penalty amounts. The accuracy related penalties were rewritten to be more inclusive and now apply to all types of tax return preparers, not just preparers of income tax returns. In addition, the range of ambiguity within which the tax preparer was permitted to operate was substantively reduced. The new standard became "the more-likely-than-not" criteria.[2] In addition, the amount and computation of the penalty became more onerous. The minimum penalty for a §6694(a) infraction was raised from a flat $250 to the greater of $1000 or 50% of the income generated by the tax preparer from that tax engagement. For §6694(b) infractions, the penalty is now the greater of $5,000 or 50% of the income generated by the tax preparer from that tax engagement.[3] In short order, the IRS issued several Notices as well as Proposed Regulations interpreting the sweeping new provisions of the 2007 law changes. Final regulations were issued at the end of 2008. However, due to, in some measure, the negative reaction of the tax profession to the more-likely than-not standard, Congress revisited the more-likely-than-not standard in 2008. As part of the 2008 Economic Stimulus Act, Congress relented and reduced the standard to a substantial authority standard. This standard is defined to be greater than the reasonable basis standard but less than the more-likely-than-not standard. Generally, it is believed that the substantial authority standard is higher than the realistic possibility standard but lower than the more-likely-than-not-standard (Desmond and Murphy (2009), Cash, Dickens, and Mowry (2007)). In addition, at least for certain types of transactions, this new standard now matches the penalty standard for tax professionals and the penalty standard for their clients (taxpayers). Thus, for qualifying transactions, the controlling certainty threshold is now the "substantial authority standard" as defined for §6694(a) purposes by the existing definition of §6662 and the related regulations.

By the end of 2008, the IRS issued several Notices as well as Proposed and Final Regulations interpreting the sweeping new provisions of the 2007 and 2008 law changes. It is important to note that this IRS rulemaking effort did more than merely seek to implement the 2007 and 2008 Act changes to the tax preparer penalty provisions. Rather, the Treasury Department took this opportunity to implement a "comprehensive review and overhaul of all the tax return preparer penalties and related regulatory provisions" with the changes proposed in the Notice as only the "first significant step in this process."[4] For example, In July, 2009 (subsequent to the issuance of the §6694 Final Regulations in December 2008), the IRS issued Notice 2009-60 requesting public comments as part of their process of "developing a comprehensive set of recommendations on return preparer performance standards by the end of 2009." In this notice, the IRS requested comments on how the tax return preparer community can assist in increasing taxpayer compliance of return preparer standards and how to ensure the tax profession meets high ethical standards of conduct.

One of the more controversial 'overhauls' in the new regulations was the elimination of the one preparer per firm rule for purposes of §6694 penalty assessments. This was replaced with a new one preparer per position rule in the Final Regulations. In the Notice, it was estimated the proposed overhaul of these provisions would increase the annual reporting burden on tax preparers by

10,679,320 hours. With the Notice, issued on December 15, 2008, the Treasury Department and the IRS issued final regulations for §6694 and §6695 (and related Code sections).

The purpose of this article is to present a brief history of the tax preparer penalty provisions and to discuss the recent major changes in this area of law and their implications for tax practice.

BACKGROUND

Original Motivation for Tax Preparer Penalties (1976)

As previously mentioned, the original focus of the penalty provisions was to address perceived fraudulent and abusive behavior on the part of certain income tax preparers. Because Congress had concerns that there were a significant number of fraudulent returns being prepared by income tax preparers and also because of a belief by Congress in widespread abusive practices by income tax preparers, the tax preparer penalties of §6694 were enacted in an attempt to reduce this perceived widespread abuse. Under §6694(a) a penalty would be imposed upon an income tax preparer of $100 if there was an understatement of tax that was due to the tax preparer's *negligent* or *intentional* disregard of rules or regulations (§6694(a)).[5] A tax preparer could avoid the §6694(a) penalties if there was a reasonable basis for disregarding a Revenue Ruling.

If the understatement was due to a willful attempt in any manner to understate the liability for a tax, the penalty was increased to $500 (§6694(b)). The explanation in the regulations suggested the primary focus of §6694(b) was on situations where the preparer willfully disregarded information furnished by the taxpayer or other persons in an attempt to wrongfully reduce the tax liability of the taxpayer (Reg. §1.6694-1(b)(2)(i)). However, the regulations state the language is broad enough to encompass intentional disregard of rules and regulations by the tax preparer as well (Reg. §1.6694-1(b)(2)(iv)). Thus, the primary focus of the 1976 tax preparer penalty provisions of §6694 was to address abusive practices by tax preparers as measured against the Code, the Regulations, and the Revenue Rulings on three related but distinct dimensions. Those three dimensions were (1) intentional disregard of rules and regulations, (2) negligent disregard of rules and regulations, and (3) willful attempt *in any manner* to understate the liability for a tax. §6694(a) addressed the first two dimensions while §6694(b) was directed to the third dimension.

First Revision of Tax Preparer Penalties (1989)

As previously mentioned, in 1989 Congress revised the §6694(a) tax preparer penalty regime not only to increase the amount of the penalty (from $100 to $250) but also, more importantly, to rewrite §6694(a). Much of the impetus for this change was Congress' attempt to move the tax practitioner towards more of a tax enforcer and away from being a tax advocate. This was due, at least in part, to the results of a 1978 IRS sponsored survey of tax preparers' attitudes. The IRS publicly presented the results in a negative light dubbing two of the results as 'sins of omission' by tax practitioners. In a Journal of Accountancy article entitled "Tax Preparers: Government Agents of Client Advocates?", authors Betty Jackson and Valerie Milliron argued that the "broad conclusions and recommendations reached are inadequately supported by the data" (Jackson and Milliron, 1989). Jackson and Milliron raised the following question with respect to these tax preparer penalties: "Does this mean the CPA's traditional role of taxpayer-advocate is being shifted gradually to playing government agent?" The potential implications of this shift, while allowing the IRS to realize short-term administrative efficiencies, may have very negative long-run implications for tax compliance to the extent taxpayers are driven away from tax practitioners (Jackson and Milliron 1989). This is problematic for compliance in non-ambiguous areas of tax law due to the complexity of both the tax law and the tax reporting process. Ultimately Jackson and Milliron argued that if taxpayers perceive that the role of the tax practitioner has become more the role of a government agent rather than that of a tax expert working for the good of the taxpayer, than taxpayers would attempt to prepare their own returns, resulting in increased non-compliance even in non-ambiguous areas of tax law.[6]

With this 1989 rewrite, Congress replaced the old criteria of negligence and intentional disregard of rules and regulations[7] with new criteria that would limit the overall range of ambiguity[8] within which an income tax return preparer could legally operate in the gray areas of the law. The new standard was called the 'realistic possibility standard.' According to the committee reports, the new standard was meant to be stricter than the old negligence standard (House Committee Reports on P.L. 101-239). The new provision was also meant to be broad in its reach, encompassing not only tax preparation but also tax planning and tax advising as well (Cash et. al. 2007). In addition, the new §6694(a) standard applied to a broader range of primary authorities than just rules and regulations. The exception Congress provided to soften the impact of the new stricter rules of §6694(a) was to permit tax preparers to take non-frivolous positions that did not meet the realistic possibility standard as long as the position was adequately disclosed on the tax return. In essence, as long as the tax practitioner gave notice to the IRS that the position lacked the requisite level of authority, the practitioner would not be subject to the 1989 §6694(a) tax preparer penalties. As additional guidance, the IRS developed regulations that, among other things, quantified the realistic possibility of success standard as a one-in-three (33%) chance of success if the position is challenged. Various authors have pointed out the inherent difficulty of quantifying these types of standards in terms of percentage probabilities. Achieving consensus with such a standard is in itself problematic given the ambiguous nature of not only the tax position itself but also the inherent subjectivity of the measurement instrument (e.g. Banoff (1991); Banoff and Coustan (1992)).

Another argument against quantifying the realistic possibility standard was the difficulty of enforcement of such a standard and the possibility that the courts might refuse to apply the standard (Banoff and Coustan (1992)). A recently released report by the Treasury Inspector General for Tax Administration (TIGTA) suggests that even the IRS appears to have been reluctant to attempt to assess the penalty. The article in the CCh Federal TAXDAY was entitled "Code Sec. §6694 Penalties Few and Far Between." For the period from January 1, 2004 to February 17, 2007, the

TIGTA reported only 525 preparers were assessed §6694 penalties. This represented less than 1 percent of the return preparers identified for that period. The article did not report the proportion of §6694(a) versus §6694(b) penalties. However, anecdotal evidence suggests the predominance of the assessments were for §6694(b) penalties. Of those assessments, 220 still had outstanding balances due as of the date of the report. It has also been suggested that there was no evidence to suggest these changes had any measurable effect on compliance (Desmond and Murphy (2009)).

Second Revision of Tax Preparer Penalty Provisions (2007)

In May of 2007 Congress passed a massive tax law, the Small Business and Work Opportunity Tax Act of 2007 (2007 Act). Once again tax preparers were in the line of fire. And once again the finger was pointed at tax preparers as not only falling short in their obligations to the tax system but also being facilitators of non-compliance by taxpayers. Once again the role of the tax professional as an advocate of the taxpayer was being challenged. "Return preparers and tax practitioners have become cannon fodder for well-choreographed attacks by politicians and others" (Rettig 2009). Congress amended the tax preparer penalties as part of the 2007 Act. The rationalization given for this attack was to narrow the estimated $300 billion tax gap. However, over the 10-year period 2007-2017 the Joint Committee on Taxation estimated the amendments to §6694 would only raise $82 million in revenue, and it was argued that the increased cost of compliance with these amendments would be much greater than the revenue expected to be generated. The 2007 Act amendments further narrowed the range of ambiguity within which the tax preparer could legally operate by replacing the realistic possibility standard with the tighter more-likely-than-not standard. This change was problematic for tax professionals in that it set a stricter standard for them (more-likely-than-not) than for their clients (substantial authority), thus setting the stage for serious and significant conflicts of interest with their clients.[9] More importantly, such a standard was considered by many to be unworkable in areas of the tax law that were unsettled and would result in a further erosion of the tax preparer's traditional role as taxpayer advocate. Exhibit 1 is a comparison of the wording from the various changes to the §6694(a) provisions.

Other substantive changes to the tax preparer penalty provisions, as previously mentioned, included expanding the definition of tax return preparer to include preparers of a wide breath of tax related forms and workpapers, not merely income tax preparation. The 2007 Act also substantively increased the amount of the penalty and changed the method of calculating the penalty.[10] To provide interim guidance until final regulations were developed, the IRS issued several Notices.[11] Proposed regulations were then issued on June 17, 2008, hearings were held on August 18, 2008, and the IRS quickly finalized the proposed regulations on December 15, 2008.

However, prior to the Treasury Department issuing the final regulations, Congress revisited §6694(a) and addressed the conflict raised by the 2007 Act more-likely-than-not standard by replacing it with the substantial authority standard for undisclosed positions.

The 2007 tax law changes as revised by the 2008 legislation and as interpreted by the new §6694 regulations and their implications for tax practice will be discussed next.

2008 §6694(A) TAX LAW REVISION

The New Standard

The Emergency Economic Stabilization Act of 2008 (EESA) replaced the more-likely-than-not standard of 2007 with the substantial authority standard used for taxpayer accuracy related penalties of §6662(d)(2). The explanation for this change given in the committee report by the Joint Committee on Taxation (JCT Rep. No. JCX-75-08) indicates the purpose of the change as follows:

> "The preparer standard for undisclosed positions is reduced to "substantial authority," which conforms to the taxpayer standard."

The new §6694(a) standard is that a position will be unreasonable and thus subject to the §6694(a) penalties unless it meets the substantial authority standard or one of the three exceptions to the substantial authority standard.[12] The first exception is for a disclosed position for which there is a reasonable basis (§6694(a)(2)(B). The second exception to the substantial authority standard is for tax shelters and reportable transactions. For tax shelters and reportable transactions, Congress retained the higher more-likely-than-not standard (§6694(a)(2)(C).

Exhibit 1: Sec. 6694. Understatement of taxpayer's liability by income tax return preparer

Original

Subsec. (a) Negligent or Intentional Disregard of Rules and Regulations.--

☐ If any part of any understatement of liability with respect to any return or claim for refund is due to the negligent or intentional disregard of rules and regulations by any person who is an income tax return preparer with respect to such return or claim, such person shall pay a penalty of $100 with respect to such return or claim.

1989 Revision:

Subsec. (a) Understatements Due to Unrealistic Positions.--

☐ If--

☐ **6694(a)(1)** any part of any understatement of liability with respect to any return or claim for refund is due to a position for which there was not a realistic possibility of being sustained on its merits,

☐ **6694(a)(2)** any person who is an income tax return preparer with respect to such return or claim knew (or reasonably should have known) of such position, and

☐ **6694(a)(3)** such position was not disclosed as provided in section 6662(d)(2)(B)(ii) or was frivolous such person shall pay a penalty of $250 with respect to such return or claim unless it is shown that there is reasonable cause for the understatement and such person acted in good faith.

Exhibit 1: Sec. 6694. Understatement of taxpayer's liability by income tax return preparer

2007 Revision:

Subsec. (a) UNDERSTATEMENT DUE TO UNREASONABLE POSITIONS. --

- ☐ **6694(a)(1)** IN GENERAL. --Any tax return preparer who prepares any return or claim for refund with respect to which any part of an understatement of liability is due to a position described in paragraph (2) shall pay a penalty with respect to each such return or claim in an amount equal to the greater of –
- ☐ **6694(a)(1)(A)** $1,000, or
- ☐ **6694(a)(1)(B)** 50 percent of the income derived (or to be derived) by the tax return preparer with respect to the return or claim.
- ☐ **6694(a)(2)** UNREASONABLE POSITION. --A position is described in this paragraph if –
- ☐ **6694(a)(2)(A)** the tax return preparer knew (or reasonably should have known) of the position,
- ☐ **6694(a)(2)(B)** there was not a reasonable belief that the position would more-likely-than-not be sustained on its merits, and
- ☐ **6694(a)(2)(C)(i)** the position was not disclosed as provided in section 6662(d)(2)(B)(ii), or
- ☐ **6694(a)(2)(C)(ii)** there was no reasonable basis for the position.
- ☐ **6694(a)(3)** REASONABLE CAUSE EXCEPTION. --No penalty shall be imposed under this subsection if it is shown that there is reasonable cause for the understatement and the tax return preparer acted in good faith

2008 Revision:

- ☐ **6694(a)** UNDERSTATEMENT DUE TO UNREASONABLE POSITIONS. --
- ☐ **6694(a)(1)** IN GENERAL. --If a tax return preparer –
- ☐ **6694(a)(1)(A)** prepares any return or claim of refund with respect to which any part of an understatement of liability is due to a position described in paragraph (2), and
- ☐ **6694(a)(1)(B)** knew (or reasonably should have known) of the position, such tax return preparer shall pay a penalty with respect to each such return or claim in an amount equal to the greater of $1,000 or 50 percent of the income derived (or to be derived) by the tax return preparer with respect to the return or claim.
- ☐ **6694(a)(2)** UNREASONABLE POSITION. --
- ☐ **6694(a)(2)(A)** IN GENERAL. --Except as otherwise provided in this paragraph, a position is described in this paragraph unless there is or was substantial authority for the position.
- ☐ **6694(a)(2)(B)** DISCLOSED POSITIONS. --If the position was disclosed as provided in section 6662(d)(2)(B)(ii)(I) and is not a position to which subparagraph (C) applies, the position is described in this paragraph unless there is a reasonable basis for the position.
- ☐ **6694(a)(2)(C)** TAX SHELTERS AND REPORTABLE TRANSACTIONS. --If the position is with respect to a tax shelter (as defined in section 6662(d)(2)(C)(ii)) or a reportable transaction to which section 6662A applies, the position is described in this paragraph unless it is reasonable to believe that the position would more-likely-than-not be sustained on its merits.
- ☐ **6694(a)(3)** REASONABLE CAUSE EXCEPTION. --No penalty shall be imposed under this subsection if it is shown that there is reasonable cause for the understatement and the tax return preparer acted in good faith.

2008 §6694(A) TAX LAW REVISION

The third exception is the reasonable cause exception from prior law. Under this third exception, a position will not be considered an unreasonable position if the tax preparer is able to show there was reasonable cause and the preparer acted in good faith (§6694(a)(3)).

The New Standard

The Emergency Economic Stabilization Act of 2008 (EESA) replaced the more-likely-than-not standard of 2007 with the substantial authority standard used for taxpayer accuracy related penalties of §6662(d)(2). The explanation for this change given in the committee report by the Joint Committee on Taxation (JCT Rep. No. JCX-75-08) indicates the purpose of the change as follows:

> "The preparer standard for undisclosed positions is reduced to "substantial authority," which conforms to the taxpayer standard."

The new §6694(a) standard is that a position will be unreasonable and thus subject to the §6694(a) penalties unless it meets the substantial authority standard or one of the three exceptions to the substantial authority standard.[13] The first exception is for a disclosed position for which there is a reasonable basis (§6694(a)(2)(B). The second exception to the substantial authority standard is for tax shelters and reportable transactions. For tax shelters and reportable transactions, Congress retained the higher more-likely-than-not standard (§6694(a)(2)(C). The third exception is the reasonable cause exception from prior law. Under this third exception, a position will not be considered an unreasonable position if the tax preparer is able to show there was reasonable cause and the preparer acted in good faith (§6694(a)(3)).

Implications of the substantial authority standard

The 2008 EESA Act change to the substantial authority standard is a positive change from a tax preparer perspective. Although more restrictive than the 1989 realistic possibility standard, it is still much more workable when dealing with unsettled areas of the law than the 2007 more-likely-than-not standard. Lipton and Walton (2009) observe that:

> "This change is welcome because for many tax return positions it is difficult to reach a more-likely-than-not level of certainty. In many circumstances, there may be multiple positions that have substantial authority, but none of the positions is more-likely-than-not correct. For example, there are complicated facts and circumstances tests for inventory and capital property determinations for which no position may be more likely than not correct."

So, there is now room for the tax preparer to advocate for their clients. Although more restrictive than the realistic possibility standard, the move to the substantial authority standard (at least as it is now envisioned) eliminates the difficulty the IRS created by imposing a numerical probability quantification process on the now obsolete realistic possibility standard. Neither the Code nor the Regulations seek to quantify the substantial authority standard. Rather, the §6662 regulations define the standard as being more stringent than the reasonable basis standard but less stringent than the more-likely-than-not standard (§§1.6662-4 (d)(2)). Thus this change to the substantial authority standard addresses the long-standing criticism many commentators have had for the quantification by the IRS of the realistic possibility standard under prior §6694 regulations. The approach enunciated in the §6662 Regulations attempts to define this standard, not in terms of odds of winning, but rather by what might be termed a 'best practices' approach in the legal reasoning process used by tax preparers in arriving at a substantial authority judgment. The advantage of this approach is that it highlights the importance of the legal reasoning process at arriving at the judgment rather than focusing on the final outcome probability of that judgment. This approach also recognizes the role of professional judgment with the inevitable differences of opinion that occur in unsettled areas of law.[14] According to the Regulations, when making a substantial authority judgment, "the weight of the authorities supporting the treatment is substantial in relation to the weight of authorities supporting contrary treatment" (Reg. §1.6662-4(d)(3)(i)). All authorities, both pro and con, must be considered and weighed in light of the pertinent facts and circumstances. In making the evaluation, three criteria are be evaluated. The three criteria are: (1) relevance, (2) persuasiveness, and (3) type of document (Reg. §1.6662-4(d)(3)(ii)). The strength of the relevance of an authority is determined be evaluating the similarity or distinguishableness of the authority on the pertinent facts and circumstances. Persuasiveness is to be evaluated in terms of the extent to which each authority cogently relates the applicable law to pertinent facts. Finally, the type of document is evaluated by assigning a weight to each type of authority in light of each authority's relative precedential value. The section 6662 regulations also identify the types of authorities that may be considered when making a substantial authority evaluation. See Table 1 for a list of the authorities.[15]

Table 1. Types of authority for purposes of making a substantial authority judgment (Reg. §1.6662-4(d)(3)(iii)).

1.	Applicable provisions of the Internal Revenue Code and other statutory provisions;
2.	Proposed, temporary and final regulations construing such statutes;
3.	Revenue rulings and revenue procedures;
4.	Tax treaties and regulations there under, and Treasury Department and other official explanations of such treaties;
5.	Court cases;
6.	Congressional intent as reflected in committee reports, joint explanatory statements of managers included in conference committee reports, and floor statements made prior to enactment by one of a bill's managers;
7.	General Explanations of tax legislation prepared by the Joint Committee on Taxation (the Blue Book);
8.	Private letter rulings and technical advice memoranda issued after October 31, 1976;
9.	Actions on decisions and general counsel memoranda issued after March 12, 1981 (as well as general counsel memoranda published in pre-1955 volumes of the Cumulative Bulletin);

Table 1. Types of authority for purposes of making a substantial authority judgment (Reg. §1.6662-4(d)(3)(iii)).	
10.	Internal Revenue Service information or press releases; and notices, announcements and other administrative pronouncements published by the Service in the Internal Revenue Bulletin;
11.	An affirmative statement in a revenue agent's report with respect to a prior taxable year of the taxpayer ("written determinations").

Date substantial authority deemed determined

Under prior law the date the return was signed by the signing preparer was the date prescribed for making the tax authority judgment for tax preparers.[16] For non-signing preparers the prescribed date was the date the advice was provided. The new Regulations continue to interpret the prescribed date in a similar manner as follows (emphasis added):

> *"Date return is deemed prepared.* For purposes of the penalties under section 6694, a return or claim for refund is deemed prepared on the ***date it is signed by the tax return preparer***. If a signing tax return preparer within the meaning of §301.7701-15(b)(1) of this chapter fails to sign the return, the return or claim for refund is deemed prepared on the date the return or claim is filed. See Sec. 1.6695-1 of this section. In the case of a nonsigning tax return preparer within the meaning of §301.7701-15(b)(2) of this chapter, the relevant date is ***the date the nonsigning tax return preparer provides the tax advice*** with respect to the position giving rise to the understatement. This date will be determined based on all the facts and circumstances" (Reg. §1-6694-1(a)(2))."

However, this is problematic as the wording of the statute was changed by the 2008 Act with respect to this issue. The wording in the §6694 statute is now (emphasis added):

> "6694(a)(2)(A) IN GENERAL. --Except as otherwise provided in this paragraph, a position is described in this paragraph unless ***there is or was*** substantial authority for the position" (§6694(a)(2)(A)."

Under prior law (2007), the relevant part of the statute reads:

> "6694(a)(2)(B) there ***was*** not a reasonable belief that the position would more-likely-than-not be sustained on its merits…"

The revised wording now mirrors the wording used in the §6662 taxpayer accuracy related penalty provisions: "if there is or was substantial authority for such treatment" §6662(d)(2)(b)(i). Since the congressional intent as expressed in the committee reports was to conform the tax preparer standard to the taxpayer standard, it would seem the interpretation of that wording by the IRS under the taxpayer penalty regime (§6662) should be the pattern for the IRS interpretation of the new tax preparer penalty regime as well. The wording in the Regulations under §6662 reads as follows (emphasis added):

> "There is substantial authority for the tax treatment of an item if there is substantial authority ***at the time the return containing the item is filed or there was substantial authority on the last day of the taxable year to which the return relates***" (Reg. §1.6662-4(d)(3)(iv)(C).

As previously mentioned, the new regulations do not adopt this interpretation but carryover the wording from the prior regulation. This suggests a conflict between the Statute (and Congressional intent) and the Regulations with potential implications for the imposition of the tax preparer penalty. For instance, if there was substantial authority on the date when the returned was filed, but there was not substantial authority on the last day of the taxable year of the return nor when the tax preparer signed the return (if non-signing, when the advice was given), is the preparer still subject to the penalty? Under the regulations as currently written the answer would seem to be the preparer is still subject to the penalty. However, a strict reading of the language of the code and the precedent set in the §6662 regulations would suggest the contrary. Thus, it will be relevant when defending against a tax preparer penalty to evaluate the strength of the authority for the position at three points in time: (1) the last day of the taxable year of the return, (2) when the tax preparer signed the return (if non-signing, when the advice was given), and (3) when the return was filed. If there is substantial authority at one of those three points, then it would seem that, in substance, the tax preparer has met the substantial authority standard of §6694.

Types of Returns Subject to Penalties

Prior to the changes introduced by the 2007 Act only preparers of income tax returns were subject to the tax preparer penalty regime of §6694. The 2007 Act broadened the definition of tax return preparer to include any paid preparer of a federal tax return. The definition of what is a federal tax return and thus who is a tax return preparer subject to §6694 was left to the IRS to identify. Reg. §301.7701-15(b)(4) defines a federal tax return as whatever tax form or other document the IRS identifies as a 'federal tax return' in published guidance in the Internal Revenue Bulletin. The IRS has, in general, followed the approach of specifically identifying those tax documents that will be considered 'tax returns' for tax preparer penalty purposes. It is worth noting that preparation of documents not generally considered tax returns now may fall within the domain of 'tax returns' as interpreted by the IRS.

Rev. Proc. 2009-11, published December 15, 2008, is the most recent published guidance and categorizes what constitutes a 'federal tax return' into three broad groups or tiers.[17] The first tier includes those documents that are definitely subject to §6694. The IRS refers to this group as 'tax returns.' Generally, this includes any federal tax form that reports a tax liability. The second tier represents those documents that may or may not be treated as 'tax returns.' These are forms and documents that do not report a tax liability but include information on them that is or may be reported on a tax document with a federal tax liability as listed in the first group. The third tier are those forms and documents that generally will not be treated as a tax return by the IRS with respect to §6694(a) penalties. However, documents in this third group may still be treated as 'tax returns' by the IRS for §6694(b) penalty purposes. In other words, preparation of documents (or a substantial portion thereof) listed in the first two categories may subject a tax preparer to §6694 (a) and/or (b) penalties. Preparation of documents listed in the third category may expose a tax return preparer only to §6694(b) penalties. Preparation of a tax form that is not included in any of the groups above, presumably, would not subject the preparer to §6694. Table 2 provides a partial listing of the tax forms in each category.

Those tax forms listed in the first group generally are intuitive and raise no issues of substantive import. Most of the listings in the second tier are also, for the most part, explicit and thus not problematic. However, as has been mentioned by prior commentators, the second tier also includes some catch-all language that appears to be designed to bring into the §6694 net not just tax forms but also an undefined array of financial and/or legal work product. Two examples provided in the Notice were cost allocation studies and depreciation schedules. Thus, individuals who may not consider themselves to be tax preparers may now discover they are subject tax preparer penalties. In a recent article, Desmond and Murphy (2009) make the following commentary on this:

> "For the multitudes of accountants, bookkeepers, and others who do not think of themselves as preparing 'returns,' but whose work is ultimately incorporated into a return (although not reflected on a document with and IRS form number on it), the 'list' approach does nothing to provide them with any indication of whether they will be considered a return preparer."

Table 2: Selected tax returns that are, may, or may not be subject to §6694 penalties per Rev Proc 2009-11.		
Tax Returns that are subject to §6694 penalties	**Tax forms and documents that may be subject to §6694 penalties**	**Tax forms and documents that are probably not subject to §6694 penalties**
(1) Income Tax Returns - Subtitle A Form 990T, Exempt Organization Business Income Tax Return; Form 1040, U.S. Individual Income Tax Return; Form 1041, U.S. Income Tax Return for Estates and Trusts; Form 1120, U.S. Corporation Income Tax Return; Form 1120S, U.S. Income Tax Return for an S Corporation; **(2) Estate and Gift Tax Returns - Subtitle B** Form 706, U.S. Estate Tax Return; **(3) Employment Tax Returns– Subtitle C** Form 940, Employer's Annual Federal Unemployment Tax Return; Form 941, Employer's QUARTERLY Federal Tax Return; **(4) Miscellaneous Excise Tax Returns - Subtitle D** Form 11-C, Occupational Tax and Registration Return for Wagering; Form 2290, Heavy Highway Vehicle Use Tax Return; **(5) Alcohol, Tobacco, and Certain Other Excise Taxes - Subtitle E** Form 8725, Excise Tax on Greenmail; and	Form 1065, U.S. Return of Partnership Income (including Schedules K-1); Form 5500, Annual Return/Report of Employee Benefit Plan; **Other Documents Constituting a Substantial Portion of a Taxpayer's Tax Return** depreciation schedules income allocation studies	Form SS-8, Determination of Worker Status; Form W-2 series of returns; Form 990, Return of Organization Exempt from Income Tax; Form 1099 series of returns; Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips;

Lipton and Walton (2009) point that the scope of this provision of the Revenue Procedure is both unprecedented and sweeping in its scope and state:

> "The more disturbing aspect of this provision is that it applies to documents prepared without any tax motivation. By including all "documents" within its scope, Rev. Proc. 2009-11 could include any document prepared within a corporation that contains information that eventually will be reflected in a tax return. Thus, for example, a corporate lawyer who prepares a purchase and sale agreement listing the amounts paid for various assets could be viewed as a tax return preparer because the "document" includes information that will be reflected on a tax return. What about the corporate lawyer who prepares an offering memorandum that discusses the tax consequences of an investment or transaction? Likewise, the title closing agent who prepares the closing balance statement that reflects a sale of real estate has prepared information that will be reflected on a return. What about the banker who provides a quarterly statement to the taxpayer—is that document reflected on a return? Would a tax return preparer include a qualified intermediary who has prepared the documents for a like-kind exchange? Although these results are somewhat nonsensical, they flow from the literal language of Rev. Proc. 2009-11."

However, the regulations do provide some relief through a de minimis rule. For an individual who is a non-signing preparer to be subject to the tax preparer penalties, the position upon which they provided advice or information must be a substantial part of the tax return. The new regulations increase the substantial threshold. Tax positions are now not considered substantial if the amount of the item is (1) less than $10,000 or (2) less than $400,000 and also less than 20% of the gross income (adjusted gross income for individuals) on the return (Reg. §301.7701-15(b)(3)(ii)(A)(1) and (2)). This relief is welcome but inadequate for the unprecedented breath of this language in the Revenue Procedure.

The forms and documents listed in the third group will only be considered 'tax returns' for purposes of the tax preparer penalty provisions if "the information reported on the document constitutes a substantial portion of the tax return or claim for refund and is prepared willfully in any manner to understate the liability of tax on a tax return or claim for refund, or in reckless or intentional disregard of rules or regulations" (Rev. Proc. 2009-11). These are forms such as W-2's, form 990's, and form 1099's.

Preparers Subject to Penalties

One of the major changes included in the new regulations is with respect to the mode of enforcement. The recently issued regulations provide that the IRS will now use a one preparer per position per firm approach rather than the one preparer per firm approach it has traditionally used. A preparer may be a signing preparer or a non-signing preparer. As previously mentioned, the non-signing preparer rules may include individuals who do not normally think of themselves as preparers. Such individuals may be caught in the §6694 net if they are deemed to be 'primarily responsible' for a position on the return. Under this new approach, the preparer within a firm identified as 'primarily responsible' for the position is the preparer subject to the penalty. Also, the IRS can treat multiple preparers as 'primarily responsible' if the preparers are in different firms (possibly the preparer penalty version of 'double taxation'). Thus, a single tax return could have multiple preparers and generate multiple penalties, depending upon the number of positions on the return deemed to be unreasonable and the number of individuals deemed to be preparers.

The IRS is also introducing a 'blanket penalty assessment' approach to encourage the practitioners in a firm to 'cooperate' in the IRS effort to 'smoke out' the 'responsible preparer'. Reg. §1.6694-1(b)(1) provides, in part, the following:

> "In the course of identifying the individual who is primarily responsible for the position, the Internal Revenue Service (IRS) may advise multiple individuals within the firm that it may be concluded that they are the individual within the firm who is primarily responsible."

This new approach for determination of the preparer primarily responsible for the position(s) on the return appears to also be coupled with the notion of a rebuttable presumption rule. The presumption is that the signing preparer is the person primarily responsible for all positions on the tax return unless they can prove otherwise. This concern was pointed out by the AICPA in comments on the proposed regulation (AICPA Comments on Proposed Regulations, REG-129243-07, August 7, 2008. The language as proposed was finalized "except for some minor conforming language."(TD 9436 (December 15, 2008). Thus, the signing preparer, to avoid the preparer penalty, is put in the position of aiding the IRS in determining who the 'responsible party' is (pass the buck) in order to protect himself against the preparer penalty regime. Finally, if within a given firm, the IRS can't decide whether a signing or a non-signing preparer is 'primarily responsible' there is what may be termed the 'deep pocket' rule. Under this provision, the penalty may be assessed against either party, but not both ((§1.6694-1(b)(4)).

Although the revised regulations are based on a one preparer per firm rule, it is possible the firm itself could also be subject to a preparer penalty if one of three conditions is met. The three conditions are: (1) if a member of the principal management or officers knew or participated, (2) if the firm failed to maintain appropriate review procedures, or (3) if the firm disregarded its review procedures willfully, recklessly or through gross indifference (§1.6694-2(a)(2)).

Disclosures that Avoid Penalties

Preparers may avoid penalties on 'unreasonable positions' if the position is disclosed and the position meets certain requirements. Those requirements are: (1) the position is not a tax shelter or reportable transaction to which §6662A applies, and (2) there is a reasonable basis for the position.

A position has a reasonable basis if it meets or exceeds the criteria as set forth in §1.6662-3(b)(3). A position that is merely arguable (not patently improper) does not meet the reasonable basis standard. Rather, the position must be reasonably based upon one or more of the authorities enumerated in Reg. §1.6662-4(d)(3)(iii).[18] It is generally recognized that reasonable basis is a lower standard than either the substantial authority or the realistic possibility standard. A preparer is also deemed to have met the reasonable basis standard if either of the following conditions apply: (1) the preparer relied in good faith without verification upon information provided by the taxpayer, or (2) the preparer relied in good faith without verification upon information and advice provided by another advisor, tax return preparer, or other party.[19] The type of disclosure that is needed for an unreasonable position that meets the reasonable basis standard is dependent upon whether the preparer is a signing or non-signing preparer.

A non-signing preparer will have met the disclosure requirements if: (1) the position is properly disclosed on the tax return, (2) if the client is advised of opportunities to avoid penalties under §6662 and the standards for disclosure, or (3) the preparer advises the 'other' tax return preparer that disclosure under §6694 may be required. Contemporaneous documentation in the preparer's records is required. It is not necessary that the disclosure be submitted to the IRS under (2) or (3). However, 'blanket' or 'boiler plate' disclosure language is not acceptable. Disclosure must address the specific issue or issues for which the preparer believes disclosure may be necessary.

For a signing preparer the choices for disclosure are narrower and include either: (1) proper disclosure to the IRS on the client tax return, or (2) documentation that preparer provided a tax return to the client with the appropriate disclosure. There is a third category of disclosure for non-accuracy related penalties that only requires the preparer advise the taxpayer of the applicable penalties. Once again, contemporaneous documentation must be retained by the preparer.

ANALYSIS/ADVICE

As reported by Rettig (2009), the IRS is now taking a much more aggressive approach in the regulation of tax preparers. The 2005-2009 IRS strategic plan included four separate enforcement objectives which included the following:

> "To assure that attorneys, accountants, and other tax practitioners adhere to professional standards and follow the law."

Rettig (2009) also quoted from the 2008 operational goals of the IRS Small Business/Self Employed Division Examination Division that IRS agents were instructed that "We will fully develop and coordinate preparer penalty issues…" and that "Penalties should be considered during every examination" (including preparer penalties). With respect to employment tax issues a similar directive was: "Examiners are required to comment on preparer penalties on all cases examined."

With the combination of the new aggressive enforcement objectives of preparer penalties by the IRS, the ever-increasing complexity of the statutory, judicial, and administrative tax law, and the potential adverse consequences of onerous sanctions in spite of a preparer's best efforts to comply, it is important that preparers take a proactive approach to creating defenses against the preparer penalty regime.[20] In addition, Rettig (2009) advises CPA's to aggressively defend themselves against even minor sanctions because of the potential adverse outcomes beyond the IRS penalty sanctions such as disciplinary actions by State Boards of Accountancy.

Some proactive defenses, in addition to the use of the disclosure provisions[21] discussed above, should include following a best practices approach as normal office practice and maintaining a clear distinction between the tax planning (advice) and the tax preparation dimensions of a tax practice. A normal office practice that follows a best practices approach will provide a defense that may be aggressively used against the preparer penalty sanctions for errors in judgment. This should include the use of engagement letters, checklists, review procedures, and contemporaneous documentation of all correspondence with taxpayer and other relevant parties.[22] To be effective, normal office practice should be designed to promote consistency and accuracy in the preparation of returns and provide a control (feedback) mechanism for improvement as weaknesses in practice are identified.

What is clear from the regulations is that the distinction between tax preparation and tax advice can be an effective defense against preparer penalties as tax advice on open transactions is normally not considered tax preparation. If tax advice is given on open transactions, such advice does not subject the tax advisor to the tax preparer penalties. Further, the tax preparer will also have a defense if it can be shown the preparer relied on this advice when taking a position in preparing the return. As discussed above, reliance in good faith by the tax preparer on the advice of others is a defense against the §6694 penalties for an unreasonable position. This would suggest the importance of separating out the tax planning functions of a tax practice from the tax preparation functions at least with respect to the §6694 penalties.

The general rule is that if the advice was given before the event occurred and any additional advice given after the event occurred represented less than 5% of the aggregate time spent by the advisor on the transaction, the tax advisor is not considered to be a non-signing preparer. However, tax advice, in certain situations, will result in the tax advisor being classified as a non-signing tax preparer and thus subject to the tax preparer penalties (Reg. §301.7701-15 (b)(2)(i)). This is deemed to occur if three conditions are met. The first condition is met if all the facts and circumstances indicate the position on the tax return was primarily attributable to the advice given. The second condition is that the advice was given prior to the event occurring with the intent to avoid being treated as a tax preparer, and the third condition is that the advice was confirmed after the event occurred for purposes of preparing the return. Examples two and three from the regulations illustrating the application follow:

> "Example 2. Attorney B, an attorney in a law firm, provides legal advice to a large corporate taxpayer regarding the tax consequences of a proposed corporate transaction. Based upon this advice, the corporate taxpayer enters into the transaction. Once the transaction is completed, the corporate taxpayer does not receive any additional advice from B with respect to the transaction. B did not provide advice with respect to events that have occurred and is not considered a tax return preparer." Reg. §301.7701-15(b)(2)(ii) example 2.
>
> Example 3.The facts are the same as Example 2, except that Attorney B provides supplemental advice to the corporate taxpayer on a phone call after the transaction is completed. Attorney B did not provide advice before the corporate transaction occurred with the primary intent to avoid being treated as a tax return preparer. The time incurred on this supplemental advice by B represented less than 5 percent of the aggregate amount of time spent by B providing tax advice on the position. B is not considered a tax return preparer." Reg. §301.7701-15(b)(2)(ii) example 3.

Even if the tax advisor meets the three conditions, the advisor will not be subject to preparer penalties as a non-signing tax preparer unless the advice applies to a 'substantial' portion of the return. As previously mentioned, for this purpose advice is not substantial if the amount of the position is (1) less than $10,000 or (2) less than $400,000 and also less than 20% of the gross income (adjusted gross income if an individual). For non-signing preparers, it becomes crucial to a defense to be able to substantiate the amount of the position and the gross income (or adjusted gross income for an individual taxpayer) with contemporaneous documentation regarding whether the preparer believes the position on which the advice is given is substantial or not. From a practical point of view, this is easier said than done and may necessitate avoidance of email and telephone advice in most situations.

As has been pointed out by various authors, not only is the tax environment a 'complex world of ever-changing statutory and case authorities,' but the ethical and regulatory environment in which tax professionals must operate is becoming more complex as well including both statutory and non-statutory standards. Within this statutory framework, tax professionals must take time, normally devoted to being sophisticated specialists in tax law, to develop a similar sophistication in managing the changing ethical and regulatory environment in which they must now operate. As pointed out by Rettig (2009), the tax practitioner is no longer viewed as a respected and dedicated professional but rather as "…cannon fodder for well-choreographed attacks by politicians and others." The tax professional has become the primary culprit in the tax system's failing credibility while the real culprit (complex and poorly designed tax law) receives a pass. In this environment, it becomes critical that the tax practitioner become proactive in developing appropriate measures to protect and lobby for themselves and their profession.

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ENDNOTES

1 The old standard, "negligent or intentional disregard of rules and regulations," was not abandoned but was, for all intents, kept as §6694(b).

2 The more-likely-than-not standard is also the criteria that must be used in evaluating uncertain tax positions for financial reporting purposes (FASB ASC 740-10 [predecessor literature: Accounting for Uncertainty in Income Taxes: FIN 48 (the 2006 FASB interpretation of SFAS 109, Accounting for Income Taxes]).

3 As a point of reference, the original penalty was a flat $100 per return.

4 See Notice of Proposed Rule Making: Proposed Regulations NPRM Reg-129243-07 (June 17, 2008).

5 The term ‘rules or regulations’ was interpreted as follows: “the Internal Revenue Code of 1954, the Treasury regulations issued under the Code, and Internal Revenue Service Revenue Rulings published in the Cumulative Bulletin refer the Internal Revenue Code, the Regulations, and IRS Revenue Rulings. Reg. ¤1.6694-1(a)(3).

6 See also, Banoff (1990) for similar argument.

7 Congress did not remove the old §6694(a) criteria but kept them by moving references to negligence and intentional disregard of rules and regulations from §6694(a) to §6694(b).

8 Ambiguity is not the same as intentional or willful disregard of rules and regulations. Rather, ambiguity in tax has been defined as the ability of parties to an exchange to act in their own self-interest within the gray areas of the system. This presents the opportunity for preparers to stretch guidelines to meet the needs of their clients (Jackson, Milliron, and Toy 1988). An important discussion that is outside the scope of this paper is the issue of whether the tax system would be better served by Congress directing their efforts to reducing ambiguity in the ‘gray areas’ of the tax law as opposed to developing penalty standards to try to restrict access to the economic benefits left open in the gray areas to astute taxpayers and their advisers.

9 Taxpayers may be subject to accuracy related penalties if they take a position on their return that lacks substantial authority (§6662).

10 The §6694(a) penalty is now the greater of $1,000 or 50% of the income derived (or to be derived) by the tax return preparer with respect to the return or claim. The §6694(b) penalty is now the greater of $5,000 or 50% of the income derived (or to be derived) by the tax return preparer with respect to the return or claim.

11 See IRS Notices 2008-46, 2008-13, 2008-12, 2008-11, 2007-54.

12 The wording for the substantial authority standard: §6694(a)(2)(A) “Except as otherwise provided in this paragraph unless there is or was substantial authority for the position,” is in substance, identical to the wording for this standard for the taxpayer accuracy related standard of §6662(d)(2)(B)(i) which was enacted by the Improved Penalty Administration and Compliance Act of 1989 (IMPACT). §6662(d)(2)(B)(i) reads: “the tax treatment of any item by the taxpayer if there is or was substantial authority for such treatment”.

13 There may be substantial authority for more than one position with respect to the same item. Reg. §1.6662-4(d)(3)(i).

14 The following are not considered authority for purposes of the substantial authority judgment: Conclusions reached in treatises, legal periodicals, legal opinions or opinions rendered by tax professionals are not authority (the authorities underlying such expressions of opinion where applicable to the facts of a particular case, however, may give rise to substantial authority for the tax treatment of an item); an authority to the extent it is overruled or modified, implicitly or explicitly, However, a Tax Court opinion is not considered to be overruled or modified by a court of appeals to which a taxpayer does not have a right of appeal, unless the Tax Court adopts the holding of the court of appeals. (Reg. §1.6662-4(d)(3)).

15 Reg. §1.6694-2(b)(5) (prior to amendment by TD 9436, 12/15/2008) read as follows:
“(5) *When “realistic possibility” determined.* For purposes of this section, the requirement that a position satisfy the realistic possibility standard must be satisfied on the date prescribed by paragraph (b)(5)(i) or (b)(5)(ii) of this section, whichever is applicable.

(i) Signing preparers.(A) In the case of a signing preparer, the relevant date is the date the preparer signs and dates the return or claim for refund.(B) If the preparer did not date the return or claim for refund, the relevant date is the date the taxpayer signed and dated the return or claim for refund. If the taxpayer also did not date the return or claim for refund, the relevant date is the date the return or claim for refund was filed.
(ii) Nonsigning preparers. In the case of a nonsigning preparer, the relevant date is the date the preparer provides the advice. That date will be determined based on all the facts and circumstances."

[16] Preparation of a tax form that is not included in the listings, presumably, would not subject the preparer to §6694.

[17] AICPA Comments on Proposed Regulations, REG-129243-07, August 7, 2008. The language as proposed was finalized "except for some minor conforming language."(TD 9436 (December 15, 2008).

[18] Acceptable authorities for making a reasonable basis decision are the same set of authorities for making a substantial authority decision. See prior discussion of this topic.

[19] The preparer penalties may be avoided even without disclosure if there was reasonable cause and good faith. Since a preparer is deemed to have met the reasonable cause and good faith exception when relying on advice and information of the taxpayer or others, generally no disclosure is necessary for these situations (Reg. §1.6694-2(e)(5) unless the advice was unreasonable on its face.

[20] In addition to IRS sanctions, a CPA may be subject to disciplinary action by his state board.

[21] An obvious hindrance to disclosing positions to the IRS is disclosure, in the final analysis, is the choice of the client not the tax preparer.

[22] As pointed out by Rettig (2009) "emails have a life of their own." Thus, an important area of internal office procedure that should not be overlooked is policy and training on when and how email should be used in tax practice. This would include caution in responding to hypothetical questions from clients.

HOW SMALL BUSINESS OWNERS CAN USE SOCIAL NETWORKING TO PROMOTE THEIR BUSINESS

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ABSTRACT

Social networking is a fast growing phenomenon in both the business and social sectors of the U.S. economy. It is a child of the Internet and provides an electronic way of person-to-person networking. This paper illustrates how small business owners can use social networking to market their business. First we consider the reasons to network online. Facebook and LinkedIn are two social networking marketing tools at the disposal of the small business owner. These are described as well as the advantages and disadvantages of each. The paper concludes with best practices and tips for using social networking.

INTRODUCTION

Small business owners typically rely on traditional means to advertise their businesses and services. These means typically include direct mail, local newspapers, fliers, radio, signage, and trade shows. With the age of the Internet we have seen the addition of websites and email marketing added to the weapons the small business owner may use. For example, Fishbowl Marketing is a promotion-based email firm in the restaurant industry. It combines restaurant and email expertise to develop email promotion programs for independent restaurant owners. Small business owners who are members of Chambers of Commerce or industry trade association such as the New Orleans Metropolitan Convention and Visitors Bureau (NOMCVB) may advertise their businesses on the organization website or send mass emailing to fellow members.

Currently if a small business owner wanted to develop business relationships he or she could go to a networking session or business card exchange conducted by a local business trade association such as a Chamber of Commerce. A new way of networking has arrived. Social media or network services such as Facebook, Twitter, and other websites have impacted how millions of Americans especially those under 35 interact or network with one another, shop and view brands (Swartz, August 28, 2009).

Businesses are spending money in social media at a faster rate than any other form of online marketing. Studies by Forrester Research show that spending on social networking will increase from $455 million in 2008 to $3.1 billion in 2014, a 335 percent increase. In contrast, spending on email marketing will grow from $1.2 billion in 2009 to 2.1 billion in 2014 (Horovitz, July 24, 2009). In addition, some 25 percent of small businesses surveyed by Adology Research said they would spend more on social networking in 2009 (Horovitz, July 24, 2009).

Interest in and the use of social networking by businesses large and small reflects the growing importance of the use of this medium. This paper illustrates how small business owners can use social networking to market their businesses. Advantages and disadvantages of two social networking tools, Facebook and LinkedIn are discussed. Guidelines for using these tools are presented.

SOCIAL NETWORKING

Social networking is the grouping of individuals into specific groups, like small rural communities or a neighborhood subdivision. Although social networking is possible in person, especially in the workplace, universities and high schools, it is most popular online. This is because like most high schools, colleges, or workplaces, the Internet is filled with millions of individuals who are looking to meet other people, to gather and share first-hand information and experiences about any number of topics from golfing and gardening to developing friendships and professional alliances (whatissocialnetworking.com, 2009).

Social networking online started as a way for friends within a school to stay connected with each other online as opposed to using a telephone or in person. The individual can decorate his or her own personal page with virtual trinkets and photos, thus expressing one's own identity or personality. Within this virtual world, they can share information, experiences, pictures, videos, and purchasing preferences including recommendations of a vendor's products or services. These recommendations have led the business community to take notice of online social networking and the power that virtual word-of-mouth advertising has on the sale of their products and services. Two sites in particular, Facebook and LinkedIn, have become particularly important in the exposure of small businesses and the wares they offer.

Facebook was founded in February 2004 and is a social utility that helps people communicate more efficiently with their friends, family and coworkers. The company develops technologies that facilitate the sharing of information through the social graph, the digital mapping of people's real-world social connections (Facebook's company website, 2009). Since 2004 Facebook has grown its membership at an exponential rate. As of September 2009, Facebook had 300 million users across the globe. The opportunity for a small business to have access to this many people was but a dream years ago, but is very real today. Facebook's ease of use and elementary directions make it a popular choice among inexperienced and advanced computer users alike.

LinkedIn is a business-oriented social networking site. Founded in December 2002 and launched in May 2003, it is mainly used for professional networking. As of October 2009, LinkedIn had more than 50 million registered users, spanning more than 200 countries and territories worldwide (Wikipedia, 2009). LinkedIn is more of an executive form of social networking. Each member fills out his or her profile, which looks more like a resume, with professional information such as work history, professional expertise, and current work experiences. LinkedIn's users are typically more skilled than a Facebook user, and its more sophisticated maneuverability and layout may frighten the inexperienced user.

WHY NETWORK ONLINE

A few reasons why businesspeople and business owners network online are:

- ♦ You can manage the information that's publicly available about you as a professional
- ♦ Find and be introduced to potential clients, service providers, and subject experts who come recommended
- ♦ Create and collaborate on projects, gather data, share files and solve problems
- ♦ Be found for business opportunities and find potential partners
- ♦ Gain new insights from discussions with likeminded professionals in private group settings
- ♦ Discover inside connections that can help you land jobs and close deals
- ♦ Post and distribute job listings to find the best talent for your company

SOCIAL NETWORKING METHODS

The use of Facebook and LinkedIn as marketing tools for small business owners is vitally important to the success or failure of these methods. Both social networking sites have advantages and challenges when using them as a medium for marketing a business. Understanding the basic and advanced techniques of both are critical to the success they can provide a small business owner.

One of the things that separates Facebook from LinkedIn is its usage as a social networking site. Facebook has a personal application where people create pages for themselves to connect with old friends, colleagues, classmates and neighbors for personal purposes such as: keeping up with family, sending pictures of kids, reminiscing about past fun and experiences, and rooting for one's favorite sports teams. It also has a professional function, where one can create a business "fan page" to introduce products and services to a massive audience, update "friends" or followers of the new happenings in one's business, alert people to the specials of the day, and/or sending people information through an information page called the "wall." Many users aren't comfortable allowing their prospects and clients to be a part of their personal life. This feature has a tendency to prevent business owners from using Facebook as a marketing medium for their business. This shouldn't prevent anyone from creating a business "fan page" as the two sites are unique to each other and users have control over the content that they expose to their prospects and clients on their "fan page" and the content they provide to the "friends" of their personal page. Depending on what type of business is being promoted, it might be an advantage to a business owner to have the ability to promote his or her products or services to the "home market."

LinkedIn is strictly a professional site, and does not have the personal elements that Facebook provides such as: personal picture and video sharing, games, polls, trinkets and other elements that are distracting to a business owner. Instead, LinkedIn is totally focused on providing a business atmosphere on its site. Even the information that one provides at the initial sign up, is strictly of a professional nature and almost resembles a quasi resume'. For some this is perceived as a tremendous advantage for LinkedIn due to the lack of distractions and professionalism of the audience.

Facebook has a very simple sign up procedure and the features within are very user friendly and easy to pick up even for an inexperienced businessperson. One can start by going to facebook.com and creating one's own personal page, and/or create a business "fan page." As stated above, the "fan page" is a tremendous way to introduce a business, products and services to the community of followers. Once one has created a "fan page" one will be able to add pictures of his or her products, services or events, display videos, post a logo, and communicate with followers. One will also be able to join groups both personal and professional where one can communicate with others, learn about events, gain insight and information, or just for fun.

LinkedIn has a more complicated sign up procedure, and it begins with going to linkedin.com. Once there one will be asked to provide one's name, a summary of one's experience, specialties, education, past business experience, a professional photo, a website, blog, or twitter account, and other business information. This is why LinkedIn is not only a great marketing resource, but can also be a great tool for recruiting top talent. One will also have the opportunity to add personal information, such as: one's birthday, phone number, address, instant message ID, and marital status. You also have control over how others find you as a member of LinkedIn, and will be prompted to add categories by which one would like to be found by others. LinkedIn has many professional groups that one can join and participate. Some of these groups may be exclusive and require acceptance into the group. This allows the group creators to control their membership and quality of the group. The discussions, questions and answers that happen in the groups and among members are some of the true value of LinkedIn. As a participant, one can answer questions and become a ranked expert in one's field.

ADVANTAGES AND DISADVANTAGES

The advantages of using social networking to market a small business can often be the same whether you are using Facebook or LinkedIn. The first advantage is being able to expose products and services to an extremely large market, yet still having a relationship component with the users. To explain this further, a restaurant will be used as an example. If a restaurant signed on to a social networking site in hopes to increase its lunch crowd through word-of-mouth referral marketing, one way that they could accomplish this is by sending out their lunch specials daily through their fan page (Facebook) or business page (LinkedIn). To take this a step further they could videotape the preparation of the meal, or post pictures of the finished product to accompany the description of the specials. In this example, the business owner is taking advantage of the photo, and video components of these social networking sites to create a visual and potentially an auditory experience for the viewer. By sending these out daily, the business will stay in contact with its existing clientele and viewers, as well as gain new viewers when links are shared. This strategy alone helped one restaurant in particular triple their lunch crowd and allowed them to sustain this growth.

Everyone has hundreds of people in their network, and if they like your product or service they might share your link with the people they have in their network, thus multiplying your network. The main difference you will find in this example between Facebook and LinkedIn, is that on Facebook it is a lot easier to spread the word, and invite new viewers. LinkedIn's policies and structure make it a bit more difficult to get a mass spreading of information between users, but this structure can also be viewed as an advantage depending on what type of business someone has and what type of clientele they want to attract. Remember, not everyone is looking for mass viewership and exposure. Some businesses may not want everyone to know who they are and may be more selective in their clientele. For businesses such as these, LinkedIn's policies and structure might be more welcomed. Think about it this way, Facebook has over 300 million users and that number is growing daily, whereas LinkedIn has 50 million viewers in over 200 countries. Executives from all Fortune 500 companies are LinkedIn members. So it all depends on whether you want to fish in a large pond with many different types of users or would rather use a targeted approach in a smaller pond where one can attract a certain type of prospect.

One of the other advantages of Facebook is the cell phone application that is available for most smart phones. This application allows the business owner to update his or her status, send links, add friends, join groups, check messages and overall communicate via one's cell phone with the entire friend list on Facebook. Two unique advantages of LinkedIn are the security features and recruiting information available. Security features allows complete control over who views the information and the control that one has in how people can contact you. They must know you or someone who does know you before they can be introduced. Second, is the recruiting aspect of LinkedIn which allows businesses to promote available positions and openings that they might have. It allows job seekers to display their information and desire for new jobs and opportunities.

As with all marketing tools there are advantages and disadvantages to the mediums you have at your disposal. Let us look at some of the disadvantages of Facebook. One is the personal versus professional mix of the population on this social networking site. Depending on what type of product or service that is trying to be promoted, access to multitudes of users who are not in your target market may be an issue. It can also introduce or re-introduce you to old friends, classmates, neighbors, and others whom you do not want to be connected or reconnected. Second, is the massive amount of games, quizzes, trinkets, and applications that have absolutely nothing to do with promoting your business. The constant updates and invitations pertaining to these nuisances can become quite annoying when trying Facebook as a function of your business. Last on the list of disadvantages for Facebook, is the potential for spamming and security issues that arise from this.

Facebook is not alone when it comes to minor disadvantages, LinkedIn has some as well. First, LinkedIn can be very technical in its methods and sometimes confusing at times. It is not as easy to find the things that one may want in one's initial use of LinkedIn and this issue can often deter users and prevent them from returning to this site. Second, LinkedIn's security features, which are definitely a positive in most cases, can be disastrous for the business trying to reach a wide audience and having very few contacts. Lastly, to obtain the most value from LinkedIn and have the ability to invite multiple people at once among other benefits, a business owner must pay for LinkedIn's premium service.

BEST PRACTICES AND TIPS FOR USING SOCIAL NETWORKING

First, know why you are networking online. Too often business owners join these sites with a desire to grow their business, but spend their time reconnecting with old friends. While it may be great to reconnect with cronies from the past, it's probably not going to give you the return on your investment in time that you had hoped for in the beginning. Second, create a limit of how much time you will spend on these sites and make that time preferably during your non-busy hours or outside of your "golden sales hours." Third, add value to any conversations that become a part of, whether in a group or just a general message sent out from you. Every time you send a message out, your followers will determine whether or not they will read the next one. Last and most important, know who your contacts know. Look at the people your followers are connected to. This will help you ask for referrals and grow your own network. Remember the door of opportunity is easier to open when someone holds it open for you.

CONCLUSION

Social networking is a fast growing phenomenon in both the business and social sectors of the U.S. economy. It is a child of the Internet and provides an electronic way of person-to-person networking, especially through Facebook and LinkedIn. Social networking is a new weapon in the arsenal of promotion weapons at the disposal of the small business owner.

The owners of small businesses must be made aware of the value of social networking in promoting their businesses especially Facebook and LinkedIn. The advantages, disadvantages, and guidelines for use need to be understood. In this brave new world of electronic networking the owner may need to attend workshops to gain an understanding of the use of social networking. Workshops are conducted by area chambers of commerce, trade associations, and technology-related groups such as the Louisiana Technology Council.

Facebook allows small business owners to use targeted marketing. Pattison (2009, November 12) presents an excellent example of this in the *New York Times*:

A wedding photographer had had little luck with traditional advertising. A full-page ad in a bridal magazine generated zero leads and a trade show yielded only four bookings, barely covering the cost of the booth. Facebook proved a digital bonanza. The photographer aimed at women ages 22 to 28 who listed their marital status as engaged and who lived in the Metro Area. The owner estimates that he spent about $300 on Facebook ads in the last two years and has generated more than $60,000 in business. About three fourths of his clients now come to him through Facebook, either from ads or recommendations from friends.

Despite successes such as those of the photographer, the use of social networking faces several challenges in the future. Companies fall into two camps. There are those who embrace social networking and those who are leary of it, perhaps due to the lack of understanding it or about the legal implications of customers helping customers (Swartz, August 28, 2009). Most corporations are still wedded to traditional electronic and print media. Still, marketers can’t afford to ignore potential customers who are using media in new ways (Swartz, August 28, 2009).

According to Swartz, (August 28, 2009) some 300,000 companies use Facebook, one- third of those being small businesses. Of these 100,000, what are their demographics? More importantly, what are the demographics and industries of the non-users? What industries are they in? Are they rural or urban in location? Why don’t they use social networking? What types of education in social networking do they need in order to use it? These questions need to be addressed in future research.

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