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THE ENTREPRENEURIAL EXECUTIVE

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LETTER FROM THE EDITOR

Welcome to the *Entrepreneurial Executive*. I am 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 my 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.

I am interested in recruiting Editorial Board members and in soliciting manuscript contributions and conference participation from a broad cross section of people interested in entrepreneurship. If you would like to become a member, contribute a manuscript, come to a conference, or just chat about the *journal*, please feel free to call, fax or e-mail me at any time.

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LETTER FROM THE PUBLISHERS

We are extremely pleased to present Volume 6 of the *EE*. The Academy of Entrepreneurship ® is an affiliate of the Allied Academies, Inc., a non profit association of scholars whose purpose is to encourage and support the advancement and exchange of knowledge, understanding and teaching throughout the world. The *EE* is a principal vehicle for achieving the objectives of the organization. The editorial mission of this journal is to advance the knowledge, understanding, and practice of entrepreneurship throughout the world. To that end, the journal publishes high quality manuscripts, which are of practical value to entrepreneurship researchers and practitioners.

As publishers, we intend to foster a supportive, mentoring effort on the part of the Editor and the referees which will result in encouraging and supporting writers. We welcome different viewpoints because in differences we find learning; in differences we develop understanding; in differences we gain knowledge and in differences we develop the discipline into a more comprehensive, less esoteric, and dynamic metier.

The Editorial Policy, background and history of the organization, and calls for conferences are published on our web site. In addition, we keep the web site updated with the latest activities of the organization. Please visit our site and know that we welcome hearing from you at any time.

JoAnn and Jim Carland
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ARTICLES

ONE MORE TIME… SHOULD SMALL COMPANIES ATTEMPT *STRATEGIC* PLANNING?

William R. Sandberg, University of South Carolina
Richard Robinson, University of South Carolina
John A. Pearce II, Villanova University

ABSTRACT

Most entrepreneurs and small company owner/ managers agree they need a plan. Pursued for an explanation, they allow that some form of a business plan, or company description and financial projections, has proven essential to establishing a line of credit, getting a loan, or attracting an investor. They often clarify their position by adding that the plan has little real value, and that it indeed has been ignored since the loan was received, the line of credit was established, or the investor brought on board. The authors from their experience have elucidated this very important concept.

INTRODUCTION

Most entrepreneurs and small company owner/ managers agree they need a plan. Pursued for an explanation, they allow that some form of a business plan, or company description and financial projections, has proven essential to establishing a line of credit, getting a loan, or attracting an investor. They often clarify their position by adding that the plan has little real value, and that it indeed has been ignored since the loan was received, the line of credit was established, or the investor brought on board.

As we have studied and worked with thousands of entrepreneurs and their businesses over the last 20 years, this perspective has begun to make sense. Admonitions to plan aside, a business or financial "plan" that serves only as a resource solicitation document is just that! Created to accomplish that objective, it is set aside so that tomorrow's efforts and undertakings may be focused on tomorrow's new objectives. So admonishing entrepreneurs with the importance of their "plan" accomplishes little and brings immediately to their minds a stale document that has served its purpose and, not surprisingly, has little contemporary relevance.

The admonition to plan could gain an audience if we simply change the semantics of the conversation to *planning*. Adding the "ing" adds the notion of action … doing … which begins to gain a bit of a raised eyelid from the entrepreneur. General Eisenhower's famous dictum, "*it's not the plan, it's the process of planning*," has a certain relevance here. He had in mind the discipline of figuring things out and a management team's give and take during that process, which gives this simple notion some credibility in the entrepreneur's mind. Unfortunately, that spark of credibility is satisfied in many entrepreneurs' minds with the follow-on notion that *yes, that planning process was useful, and the next time we need to create a business plan or financial plan for our banker or investor the process will be more appreciated as a meaningful activity*. Or, for the more humorous entrepreneur, it is synonymous with the notion that *planning* *by the seat of your pants usually means you end up with torn pants*. Both such follow-on notions are sadly incomplete.

IDEAS AND PERSISTENCE ARE NOT ENOUGH

What's missing from this contemplation and discussion of the lasting value of planning, or even of a plan, may still be a matter of semantics. At the risk of over-simplifying something that may truly be profound, the issue may boil down to the word *strategic* and what it means, or should mean, to the entrepreneur or small business when coupled to the word *plan*, or more importantly, *planning*.

Most of us are familiar with common arguments-by-analogy in favor of *strategic* planning by small businesses. They often sound something like the following: "*No strategic plan? Would you travel through unfamiliar territory without a map*?" We've heard this one countless times, and it sounds reasonable to us – but then we already believe in the value of strategic planning to small businesses.

Many owners and managers of small businesses, on the other hand, are less convinced of its value. They object that the road to success isn't waiting, paved and marked, for the entrepreneur who remembered to bring the map – and they're right! And they're right again when they add that successful entrepreneurs start out with an idea, a concept, or an urge, and combine it with persistence. The sad fact is, however, that these ingredients are necessary but not sufficient conditions for success.

Research and experience show that nearly all entrepreneurs – successful and failed – start with an idea, concept, or urge. Many of them persist, some even when failure should be obvious. A few are "lucky" but hardly enough to account for the majority of successes. Besides, as football coach Ara Parseghian used to tell his teams, "Luck is when preparation meets opportunity." In business, preparation comes through *strategic* planning.

THE VALUE OF A STRATEGY

Many owners and managers of small businesses routinely plan their day-to-day operations but don't believe that *strategic* planning applies to them. Mention strategic planning, and they think of elaborate bound documents resting on bookshelves in the offices of large companies, or of the detailed plans used in project management. That's where many small businesses go wrong. No business is too small to require a sound strategy, and few strategies are so simple that they need not be developed into a strategic plan. Our hope in writing this article is briefly to explain why small businesses need a strategic plan and to suggest several sources of detailed guidance for readers who wish to learn more.

A strategy spells out three elements that are essential to any business: (1) its *goals*, (2) the *policies* or rules that guide its decisions, and (3) the *actions* intended to accomplish its goals. This seems cut-and-dried, but actually developing and executing a strategy is far from a routine, connect-the-dots process. The thinking behind a strategy need not be sophisticated, but nevertheless must be thorough and careful.

A firm's strategy should serve as its *logic for competing* – a coherent encapsulation of its products and services, the markets and types of customers it serves, and the benefits they derive. From this logic come the firm's decisions on how to position itself against rivals, on which markets to focus, and which opportunities to pursue. A strategy also should summarize the firm's *logic for organizing* – an identification of key activities and how they will be carried out to realize the logic for competing. From the logic for organizing come decisions on which activities are critical to the firm's success, how the tasks required by these activities should be grouped into jobs, and what criteria are appropriate in evaluating the performance of those jobs. Tight integration of the logics for competing and for organizing lays the foundation for the firm's *competitive advantage* – the basis of its superiority over rivals in serving a particular market or market segments.

THE PERIL OF HAVING *NO* STRATEGY

Over the past twenty years we have worked with over 1,000 small businesses, either supervising teams of students who consulted to them or on a personal consulting basis. Our observations of these and other small businesses square with what experts have written: *At least half of small businesses do not have a strategy*. The consequences vary in their particulars, but the pattern of increased failure is clear among these companies.

Without a strategy's *logic for competing*, a florist clambered vainly after each specialized market developed by her successful rivals, never identifying a market opportunity suited to her own resources and location. A home-inspection service struggled to survive, seeking business directly from homeowners through small advertisements and business cards posted on bulletin boards while rivals developed productive relations with leading realtors. The partners in a startup venture to produce an industrial product drained their capital in securing a production site, equipment, and component parts prior to identifying a target market or the distribution channel to reach one.

Without a strategy's *logic for organizing*, a graphic arts partnership identified one market as its primary target but devoted most of its sales efforts to two other markets. Lacking knowledge of its own costs-by-products, a producer of consumer commodities vigorously promoted items on which, at best, it broken even and neglected items that earned robust margins. A restaurateur attempted to combine large-volume, off-site catering and a diverse, sit-down luncheon menu from one small kitchen.

Each of these businesses benefitted from an entrepreneur's idea, concept, or urge, and each entrepreneur labored with total devotion to make it succeed. And ofttimes that devotion to success can be documented though one or more "plans" that became dust-collecting reminders of loans won or investments sold. Yet each of these businesses failed or came perilously close to failure because it lacked a coherent strategy, expressed in a *strategic* plan. Their entrepreneurs' close attention to daily operations and immediate tactics, as well as their occasional business plans, were not sufficient to ensure survival, let alone success, in the absence of a logic for competing or of a logic for organizing.

GETTING STARTED ON STRATEGIC PLANNING

We don't mean to suggest that any strategy is better than none. We have seen companies killed by strategies so wrong-headed that they probably were worse that unguided, reactive decisions. With that experience in mind, we urge owners and managers of small companies to do strategic planning, and do it well.

Many good sources of advice and guidance are available. We will recommend several that can get you started. Complete reference information for each book is provided at the end of this article.

For an introduction to *strategic* planning and related issues in the small business, we suggest that you consider two books. *Simplified Strategic Planning: A No-Nonsense Guide for Busy People Who Want Results Fast!* is the product of extensive work by its authors with small and medium-sized businesses. The book presents straightforward, concise guidance (including planning templates) and a logical sequence for developing a strategic plan without a large staff. While it draws heavily on the academic work of leading researchers James Brian Quinn (Dartmouth/Tuck) and Michael Porter (Harvard), the book has a firm grounding in the environment of businesses that cannot ignore daily operational requirements for the sake of planning. A second introductory book, *Applied Strategic Planning: How to Develop a Plan That Really Works*, was written by three consultants and trainers and offers a clear, effective way to identify and implement strategic objectives. It covers all phases of the strategic planning process, including determining if an organization is ready for strategic planning. The book offers numerous charts, diagrams, and checklists to aid readers in applying its ideas to their businesses. It is particularly appropriate for the beginning strategic planner.

The entrepreneur or small company builder who wants to take strategy development to its highest level might consider one of the following books. *Leading the Revolution*, by Gary Hamel, is a recent, important best seller that integrates the arguments of many leading thinkers into one set of procedures for constantly establishing and superbly implementing improved business models for customer interfaces, core strategy, using strategic resources, and value networks. *Corporate Strategy: A Resource-Based Approach*, by David Collis and Cynthia Montgomery, gives small company owners several conceptual tools, built around the notion of a company's strategy being crafted from a unique understanding of its true strategic resources, with which to guide quality strategic thinking and analysis of their company and shape sound strategies. Finally, Michael Porter offers a time-tested set of three classic books to guide your strategic thinking: *Michael Porter on Competition, Competitive Strategy,* and *Competitive Advantage*. Martyn Richard Jones, founder of Iniciativas, a management consulting firm, had this to say in an Amazon.com book review (March 3, 2001) about Porter's books: "You can always tell when it's time to dust off the old Michael E. Porter books and to start to frantically search for better and sounder ways to do business and compete, it's when the economy starts to get a little tighter and begin to show signs of taking a down-turn, like about now. So, before you fork out good money and time to read the next grandiose book on how to make a fast few million bucks on the internet read this first, and you will still be in business this time next year, and after that-maybe."

A final set of reading recommendations involves strategy implementation. As important as the competitive logic behind a strategy can be, it is execution of those ideas that determine success. One new book, *The Strategy-Focused Organization: How Balanced Scorecard Companies Thrive in the New Business Environment*, by Robert Kaplan and David Norton, offers an impressive framework building upon their "balanced scoreboard" approach for the implementation of strategy. Their research suggests that 90% of strategic plans fail due not to formulation but to implementation difficulties. This books suggests ways to align and link all parts of an organization to its strategy and offers numerous examples to help managers adapt their ideas. In short, it addressed the logic of organizing. A second book, *Formulation, Implementation and Control of Competitive Strategy*, by Jack Pearce and Richard Robinson, offers broad coverage of a variety of concepts and models for implementing and controlling strategy execution.

John Naisbett's book, *Global Paradox*, predicted that the larger and more interconnected the world economy becomes, the more important become the smallest players in that economy. We mention this book in closing because Naisbett's evidence is compelling: the rate of change, the impact of technology, the importance of speed, and the ability to reach anywhere in the world --- all create the opportunity for competitive advantage among smaller companies. And large companies are rapidly deconstructing and reorganizing to respond to this critical advantage that's inherent to their smaller competitors. With so much 21st century opportunity, many entrepreneurs with excellent ideas, concepts, or urges will labor with total devotion to build new companies. Yet history suggests that many of these exciting new businesses will fail or come perilously close to failure because they lack a coherent *strategy*, expressed in a *strategic* plan. The entrepreneurs' close attention to daily operations and immediate tactics, as well as their occasional business plans, will not be sufficient to ensure survival, let alone success. In this historical period of global opportunity for small business, that will be a shame.

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ARE THE COMMON MYTHS OF ENTREPRENEURSHIP ALL THAT COMMON? A TEST OF ENTREPRENEURS AND NON-ENTREPRENEURS

Kevin W. Sightler, Kennesaw State University

ABSTRACT

It has been suggested that there is general misunderstanding in the business and academic communities as to the definition, form, and substance of entrepreneurship. Common myths of entrepreneurship have been advanced such as "Entrepreneurship involves starting and running a small business" and "Entrepreneurship requires a lot of money." A sample of 163 subjects revealed overall disagreement with the stated myths. Evidence supported a hypothesized divergence of opinion about entrepreneurship myths between entrepreneurs and non-entrepreneurs, but there was no difference of opinion between less successful and more successful entrepreneurs. Implications of the findings are discussed.

INTRODUCTION AND BACKGROUND

As economies expand and develop globally, entrepreneurial activity is seen as a cornerstone of the developmental process, whether by new, start-up firms or by new ventures from within existing firms. Morris (1998) boldly claims that we have entered the "Age of Entrepreneurship." A recent survey revealed that 80% of the opinion leaders questioned believe that entrepreneurship will be the defining business trend in the next century. Factors identified as driving the trend include technology advancements, a high growth/low inflation economy, social factors, globalization of economies, large companies' inability to adapt, and government deregulation (Carey & Tian, 1998).

Entrepreneurs' challenges are different from those encountered by the prototypical manager. Bhide (1996) suggests that the issues entrepreneurs face every day would overwhelm the typical manager. Entrepreneurs frequently operate without the "safety net" possibly afforded managers in traditional organ-izations. They are often forging into uncharted competitive and technological territories with little if any history to act as guideposts. There is probably agreement in the general population that entrepreneurship is defined in terms of assumption of risk, innovation, and an ability to create and manage change. Academicians and business people alike identify certain elements of entrepreneurial skill as a requisite component of viable company strategy. Entrepreneurship is key to the creation of new business models; that is, novel business forms, products/services and/or delivery systems. Internet-based companies such as Yahoo! and Amazon.com are good examples of new business models. Gardner and Gardner (1999) identify "visionary entrepreneurship", converting what was once seen as impractical dreams into tangible powerful businesses, as a requirement for building great companies.

As important and pervasive as entrepreneurship is today, there may be disagreement or misconception as to what truly constitutes entrepreneurship. Pitt (1998) suggests that entre-preneurship is in danger of becoming yet another "buzzword," popularized yet bastardized by the popular press, consultants, and entrepreneurs themselves. Pitt observes "entrepreneurial" descriptions applied to issues and objects as diverse as competitive strategy, performance potential observed in children, and leadership.

Morris (1998) suggests that entrepreneurship is a concrete, measurable, and essential phenomenon for individual, organizational, and societal success. He eschews the traditional conceptualizations of entrepreneurship as vague and replete with popular myths and misunderstandings. He further argues that virtually everyone has entrepreneurial potential and that unleashing this potential can positively affect one's environment to make meaningful, significant contributions. He introduces the concept of "entrepreneurial intensity" as the strength and frequency of entrepreneurship, conceptualized and operationalized on a continuous scale across all levels of analysis. Morris provides a framework that explains, among other things, the influences on the entrepreneurial process (including misconceptions or myths) and the importance and pervasiveness of entrepreneurship in everyone's lives.

In building his argument and evidence for the entrepreneurial intensity construct, Morris begins by identifying and defining what he believes to be 13 common myths of entrepreneurship. These myths, individually and collectively, contribute to the general misunderstanding of what he believes constitutes entrepreneurship. He also suggests that these common myths may negatively influence would-be entrepreneurs by giving a false impression of the nature of entrepreneurship. He then integrates the 13 myths throughout the remainder of his book as he skillfully builds his conceptualization of entrepreneurial intensity.

STATEMENT OF THE PROBLEM AND HYPOTHESES

Morris (1998, pp. 1-11] posits the following common myths of entrepreneurship:

- Entrepreneurship is about starting and running a small business
- Entrepreneurship is a discrete event that just “happens”
- Entrepreneurship is an “Either/Or” thing
- Entrepreneurship is about taking wild risks
- Entrepreneurs are born
- Entrepreneurship is about greed
- There is only one type of entrepreneur
- Entrepreneurship is about individuals
- Entrepreneurship requires lots of money
- Entrepreneurship is about luck
- Entrepreneurship starts with a new product or service
- Entrepreneurship is unstructured and chaotic
- Most entrepreneurial ventures fail

In consultation with several experts in entrepreneurship, I subjectively concluded the face validity of the stated myths. Unanswered, however, was the question of whether entrepreneurs in general would agree that the stated myths are, indeed, myths. Likewise unanswered was whether non-entrepreneurs agree with the myths as stated. This would appear to be of particular importance to the argument for entrepreneurial intensity, as these presumed myths are elements on which the concept is developed. The validity of the statements as myths would also be of interest to practicing and aspiring entrepreneurs and those involved in educating and developing entrepreneurs. Therefore, I set out to determine the level of convergence and divergence of opinion between entrepreneurs and non-entrepreneurs with respect to Morris' presumed myths of entrepreneurship. One would expect entrepreneurs to more strongly disagree with the stated myths, partially confirming their status as a myth. Non-entrepreneurs, because of their limited knowledge of and experience with entrepreneurial ventures, would be expected to more strongly agree with the stated myths if they are, indeed, myths.

To address these questions, two hypotheses were formulated:

H1: Entrepreneurs (E) will more strongly disagree with the stated myths of entrepreneurship than will non-entrepreneurs (NE) as measured by the entrepreneurial myths scale (EMS).

$H1_0$: Mean $EMS_{(E)}$ = Mean $EMS_{(NE)}$

$H1_a$: Mean $EMS_{(E)} \leq$ Mean $EMS_{(NE)}$

H2: More successful entrepreneurs (MS) will more strongly disagree with the stated myths of entrepreneurship than will less successful entrepreneurs (LS) as measured by the entrepreneurial myths scale (EMS).

$H2_0$: Mean $EMS_{(MS)}$ = Mean $EMS_{(LS)}$

$H2_a$: Mean $EMS_{(MS)} \leq$ Mean $EMS_{(LS)}$

METHODS

Sample

To test these hypotheses, a survey was constructed and distributed for voluntary completion to students enrolled in two undergraduate management classes at a large southeastern university. The use of a student sample from this university seemed particularly appropriate. This non-residential university services students primarily from a large, urban and suburban population with many students working full-time and going to school part-time. The average age of the university's students is well above that of traditional, residential institutions. Also, this institution has nationally-ranked graduate and undergraduate entrepreneurship programs that attract entrepreneurs, would-be entrepreneurs, and non-entrepreneurs alike (U.S. News & World Report, 1998; Up and comers: 25 schools to watch, 1995). The United States Association of Small Business and Entrepreneurship (USASBE) recognized the institution in 1998 as a model for undergraduate entrepreneurship education. Tables 1 and 2 show select demographic and biographic data for the sample. The 163 subjects' age ranged from 19 to 54 with an average of 25.5 years. On average, subjects had almost 10 years of combined full- and part-time work experience. About 39% identified themselves as current or former entrepreneurs.

Instrument

The survey contained 166 items. A subset was used to test the hypotheses and is presented in the appendix.

Table 1
Continuous Variables Descriptive Statistics

Variable	n	Mean	Std. Dev.	Min.	Max.
Full-Time Work Experience (Years)	163	5.31	6.38	0	30
Part-Time Work Experience (Years)	163	4.32	2.72	0	15
Managerial Work Experience (Years)	163	2.18	3.68	0	20
Age	163	25.52	6.67	19	54
Work Experience (Full and Part Time)	163	9.63	6.50	1	32
Cumulative GPA	158	3.13	0.48	2.00	4.00

Table 2
Discrete Variables Frequency Distributions

Variable	Response	Frequency	Percentage
Current or Past Entrepreneur	Yes	63	38.9%
	No	99	61.1%
Success of Entrepreneurial Ventures	Very Successful	9	13.9%
	Moderately Successful	34	52.3%
	Neutral	19	29.2%
	Moderately Unsuccessful	2	3.1%
	Very Unsuccessful	1	1.5%
Likelihood of Engaging in Entrepreneurial Ventures in the Future	Very Likely	45	28.5%
	Somewhat Likely	50	31.7%
	Unsure	43	27.2%
	Somewhat Unlikely	10	6.3%
	Very Unlikely	10	6.3%

Subjects received extra credit for completing the survey and were not asked to identify themselves on the survey. Confidentiality was assured. The participation rate was 99%. In the entrepreneurial myths section of the survey, subjects were told they were being asked for their opinions about entrepreneurs and entrepreneurship. They were given the following definition to guide their responses:

> *Entrepreneurship is the process through which individuals and teams create value by bringing together a unique collection of resources to take advantage of opportunities. It can occur in any organizational context and results in a variety of possible outcomes, including new ventures, products, services, processes, markets, and technologies.*

This is an adaptation of Morris' (1998, p. 16) definition of entrepreneurship as a synthesis of contemporary definitions and perspectives from the entrepreneurship literature. This definition embodies his view that entrepreneurship is defined by three key dimensions: innovativeness, risk taking, and proactiveness (Oviatt, 1999).

Subjects were then asked to indicate their agreement or disagree with each of the stated 13 myths of entrepreneurship. The 13 myths, as listed earlier, were selected and presented on the survey in random order. Responses were indicated on a 5-point Likert-type scale with verbal anchors—1=Strongly Disagree; 2=Disagree; 3=Neutral; 4=Agree; and 5=Strongly Agree. Three items were selected at random and restated in the opposite and then reverse scored for analysis. These three items (numbers 6, 10, and 11) are presented in original form in Table 3 to facilitate consistent scale interpretation of the scores. Some items, as shown in Table 3, were slightly re-worded from Morris' original statements for readability and interpretation.

An entrepreneurial myths scale (EMS) score was constructed by averaging, for each subject, the numerical responses to the 13 myth statements. Subjects were also asked, using the definition of entrepreneurship stated earlier, to indicate if they considered themselves now or had ever considered themselves in the past to be an entrepreneur. Responses were indicated as either "Yes" or "No." Those who responded in the affirmative were then asked to indicate their perception of their own entrepreneurial success. All subjects were asked to indicate their perceived likelihood of engaging in entrepreneurial ventures in the future. The responses to these three items were summarized in Table 2.

RESULTS

The average response to each of the 13 stated entrepreneurial myths is shown in Table 3. Based on a 5-point scale, relatively low numbers represent disagreement with the statement, relatively high numbers represent agreement with the statement. Thus, a lower number representing disagreement with the statement suggests that the statement is perceived to be untrue. Likewise, a higher number representing agreement with the statement suggests that the statement is perceived to be true.

The average EMS score of 2.87 (SD=0.44) indicates that, overall, subjects are in slight disagreement with the statements and suggests, on average, that the statements might be perceived as untrue. Individual subjects' EMS scores ranged from 1.38 to 3.92.

Table 3
Entrepreneurial Myths Scale and Scale Items Descriptive Statistics

Item		n	Mean	Std. Dev.
EMS	*Entrepreneurial Myths Scale (Average of Individual Scale Items)*	162	2.87	0.44
1.	Entrepreneurs are "gamblers" willing to take wild risks	163	3.52	1.17
2.	Entrepreneurship starts with a new product or service	163	2.93	1.20
3.	Most entrepreneurial ventures fail	162	2.72	0.97
4.	Entrepreneurs tend to be very similar to each other	163	2.90	1.12
5.	Entrepreneurship is a fixed event that occurs at a particular point in time	163	1.93	0.97
6.	Entrepreneurship is about greed	163	2.36	0.97
7.	Entrepreneurship is mostly about luck	163	2.25	1.01
8.	Either a person **is** or **is not** an entrepreneur	163	3.07	1.25
9.	Entrepreneurs are born, not made	163	2.38	1.23
10.	Entrepreneurship is unstructured and chaotic	162	3.01	1.08
11.	Entrepreneurship requires a lot of money	163	3.58	0.99
12.	Entrepreneurs try to do as much as they can themselves, seldom relying on others	163	3.08	1.01
13.	Entrepreneurship is about starting and running a small business	163	3.55	1.09

Note: Responses were indicated on a 5 point scale with "1" representing "Strongly Disagree" and "5" representing "Strongly Agree". On the survey, Items 6, 10, and 11 were restated in the opposite and then reverse scored. They are not presented in the opposite here to aid in the interpretation of the scores.

The average of each item across subjects is more telling. Item # 5 has the lowest average score of 1.93

(SD=0.97). This indicates a relatively strong disagreement with the statement that entrepreneurship is a fixed event that occurs at a given point in time. Items 7 (entrepreneurship is mostly about luck) and 6 (entrepreneurship is about greed) have the next lowest average scores (2.25 (SD=1.01) and 2.36 (SD=0.97), respectively). Item 11 has the highest average score at 3.58 (SD=0.99). Subjects have a relatively high agreement with the position that entrepreneurship requires a great deal of money. Morris (1998) suggests that this is a myth; that entrepreneurship does **not** require a great deal of money. The second and third highest average responses were for Item 13 (entrepreneurship is about starting and running a small business, mean=3.55, SD=1.09) and Item 1 (entrepreneurs gamble by taking wild risks, mean=3.52, SD=1.17), respectively. Notice that the standard deviation across all 13 averages is fairly high, ranging from 0.97 to 1.25 (on a 5-point scale).

Table 4 shows the first-order Pearson correlation coefficients among all 13 EMS items. The strongest ($p < .001$) correlation, 0.42, is between Items 8 and 9: 'Either a person is or is not an entrepreneur' and 'Entrepreneurs are born, not made.' Also strongly correlated are Items 1 and 2, Items 5 and 7, and Items 7 and 9, each with a significant ($p < .001$) positive pairwise correlation.

Hypothesis # 1

It was hypothesized that entrepreneurs will more strongly disagree with the stated myths of entrepreneurship than will non-entrepreneurs. A 2-sample one-tail unequal variance modified t-test was used to test this hypothesis. Results are shown in Table 5. The null hypothesis is rejected and Hypothesis # 1 is supported (p<.05). The evidence suggests that entrepreneurs more strongly disagree with the stated myths compared to non-entrepreneurs.

Table 4
Entrepreneurship Myth Scale Items Correlations

	1	2	3	4	5	6	7	8	9	10	11	12	13
1	--												
2	0.29[a]	--											
3	.012	0.15	--										
4	-0.01	0.14	0.16[c]										
5	-0.02	0.17[c]	0.11	0.14	--								
6	0.12	0.19[c]	0.09	0.10	0.23[b]								
7	0.12	0.25[b]	0.20[b]	0.11	0.31[a]	0.19[c]	--						
8	0.09	0.08	0.13	0.13	-0.05	0.13	0.07	--					
9	0.12	0.18[c]	0.17[c]	0.12	0.09	0.12	0.27[a]	0.42[a]	--				
10	0.03	0.08	0.07	-0.06	-0.19[c]	0.18[c]	0.13	0.13	0.01	--			
11	0.13	0.03	-0.08	0.07	-0.10	0.09	0.01	0.04	0.04	0.16[c]	--		
12	0.00	0.14	0.00	0.03	0.11	0.02	-0.06	-0.03	0.15	-0.17[c]	-0.14	--	
13	0.18[c]	0.22[b]	0.08	0.04	0.06	-0.01	0.13	0.05	0.01	-0.10	0.16[c]	0.20[b]	--

a: p<.001 b: p<.01 c: p<.05

Because the overall EMS score across groups was significant, each of the 13 scale items was compared across groups to identify items contributing to the overall effect. Items 6, 10, and 11 were significantly different with entrepreneurs giving lower ratings (i.e., higher disagreement) than non-entrepreneurs. The entrepreneurs significantly disagreed with non-entrepreneurs on the statements that entrepreneurship is about greed (p<.01), that entrepreneurship is unstructured and chaotic (p<.05), and that entrepreneurship requires a lot of money (p<.05). Coincidentally, these were the three items that were randomly selected and stated in the opposite on the survey and then reverse scored for analysis.

Table 5: Results of Hypothesis Tests							
Hypothesis #1							
Variable	**Groups**						**T statistic**
	Entrepreneurs			**Non Entrepreneurs**			
	Mean	**SD**	**n**	**Mean**	**SD**	**N**	
EMS	2.78	0.54	62	2.92	0.35	98	1.8277 * ∳
Item 1	3.48	1.34	63	5.56	1.06	99	0.4179
Item 2	2379	1.32	63	3.02	1.12	99	1.1667
Item 3	2.66	1.09	62	2.75	0.91	99	0.5432
Item 4	2.97	1.05	63	2.85	1.17	99	-0.6603
Item 5	1.78	0.83	63	2.03	1.03	99	1.6303
Item 6	2.14	0.96	63	2.51	0.94	99	2.3651 **
Item 7	2.10	1.00	63	2.34	1.01	99	1.5317
Item 8	3.10	1.30	63	3.06	1.22	99	-0.1715
Item 9	2.43	1.30	63	2.35	1.19	99	-0.3770
Item 10	2.79	1.05	63	3.13	1.09	98	1.9536 *
Item 11	3.37	1.08	63	3.72	0.93	99	2.2077 *
Item 12	3.16	0.97	63	3.02	1.03	99	-0.8532
Item 13	3.41	1.28	63	3.64	0.95	99	1.2729 ∳
Hypothesis #2							
Variable	**Groups**						**t-Statistic**
	More Successful Entrepreneurs			**Less Successful Entrepreneurs**			
	Mean	**SD**	**n**	**Mean**	**SD**	**N**	
EMS	2.76	0.53	41	2.82	0.57	21	0.4647
**p<.01 *p<.05 ∳ Unequal variance modified t-test							

Hypothesis # 2

It was also hypothesized that more successful entrepreneurs will more strongly disagree with the stated myths of entrepreneurship than will less successful entrepreneurs. Respondents indicating their overall entrepreneurial experience as “very successful” or “moderately successful” were categorized as “more successful” for testing this hypothesis. Respondents indicating “neutral,” “moderately unsuccessful,” or “very unsuccessful” were categorized as “less successful.” Only those respondents indicating that they were currently entrepreneurs or had been entrepreneurs in the past provided responses to their perceived entrepreneurial success (n=63).

Using a 2-sample one-tail t-test, this hypothesis was tested and the results are also shown in Table 5. The evidence is insufficient to reject the null hypothesis, suggesting no significant difference in EMS between more successful and less successful entrepreneurs.

SUMMARY AND DISCUSSION

Thirteen statements have been advanced that purport to represent common myths about entrepreneurs and entrepreneurship. I tested those statements vis-à-vis groups of entrepreneurs and non-entrepreneurs and found, overall, general disagreement with the statements. Entrepreneurs more strongly disagreed with the statements than did non-entrepreneurs. However, there was no difference in the level of disagreement between less successful entrepreneurs and more successful entrepreneurs.

Establishing the content validity of these presumed myths presents something of a conundrum. If the statements were, in fact, generally perceived misconceptions about entrepreneurship, then this would be confirmed, in part, by a significant proportion of the population agreeing with the statements. For example, if most people equate entrepreneurship with starting and running a small business, as Morris asserts they do, then this would be a necessary yet insufficient test of validity. We would then require sufficient evidence and argument to successfully challenge the truthfulness of the statement. Thus the myth validity can be established only if we determine that a sufficient proportion of people agree with the statements that can be successfully argued as untrue.

Let us assume that Morris has successfully established the second condition of validity as discussed above. Indeed, he does present quite compelling discussions of each of the 13 assumed myths in his text. Therefore, the first condition of validity as discussed above would remain to be established. The evidence presented herein does not establish that condition. Recall that, overall, the subjects disagreed with the stated myths, just the opposite of the condition required. Can, then, we conclude that the evidence does not support these statements to be common myths about entrepreneurship?

I suggest the evidence of this study *partially* supports the validity of the stated myths. While the respondents in general did not agree with the stated myths, there was a significant difference in the level of disagreement between entrepreneurs and non-entrepreneurs. The non-entrepreneurs had higher levels of agreement with the stated myths; not agreement *per se*, but higher levels of agreement with the statements than non-entrepreneurs. As non-entrepreneurs are presumably less knowledgeable about the content and processes of entrepreneurship, we would expect them to be more strongly in agreement with the stated myths if the myths are true. Morris contends that entrepreneurs harbor the same misconceptions about entrepreneurship as non-entrepreneurs. The evidence in this study suggests that entrepreneurs are less likely to agree with the stated myths than non-entrepreneurs, suggesting that entrepreneurs have a more realistic perspective on entrepreneurship than Morris might have believed.

Of the individual myth statements, only three of the 13 differed significantly between entrepreneurs and non-entrepreneurs. A factor analysis of the EMS scale is called for to determine if the variance between groups could be narrowed to its most significant points of divergence (we did this with separate univariate tests; the multivariate factor analysis would determine joint relationship). I also suspect that the differences would be greater if the sample of non-entrepreneurs had not been selected from management classes in a well-known management and entrepreneurship institution where they likely had already had at least some exposure to entrepreneurship in other courses.

In conclusion, this study found limited support for the validity of Morris' common myths of entrepreneurship, warranting additional study to determine if the information should be integrated into the training and development of entrepreneurs as well as entrepreneurship research.

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APPENDIX A

Note: The data represented in this paper are a subset of the information collected on a 166-item workplace opinion survey. In addition to entrepreneurial myths perceptions, data were collected on locus on control, birth order, national origin, immigrant status of parents, cognitive styles, impostor phenomenon, downsizing experience, felt stress and coping skills, and work impact on family and family impact on work perceptions. The items below were used to collect the data reported in this paper.

Workplace Opinions Survey

Thank you for taking time to complete this survey. You are participating in the pre-test phase of developing a much larger, comprehensive, survey that will be completed by hundreds of practicing managers, entrepreneurs, and students. By participating, you will help us improve the quality of the survey.

This survey asks for your assessment of certain workplace behaviors and attitudes. Most questions require you to indicate your responses with check marks or by circling a letter or a number.

Try to complete all questions in one sitting. Answer the questions quickly, but try not to hurry. Don’t agonize over any one question; just make a choice and move on to the others.

Remember: This is a survey, not a test—there are no “right” or “wrong” answers. All you have to do is give your honest opinion. Participating in this survey is voluntary and confidential. You are **not** asked for your name. Please do not write your name anywhere on this survey. All responses are strictly confidential and will be used for academic research only.

Thank you, again, for taking the time to complete this survey.

	Strongly Disagree				*Strongly Agree*
1. Entrepreneurs are "gamblers" willing to take wild risks	1	2	3	4	5
2. Entrepreneurship starts with a new product or service	1	2	3	4	5
3. Most entrepreneurial ventures fail	1	2	3	4	5
4. Entrepreneurs tend to be very similar to each other	1	2	3	4	5
5. Entrepreneurship is a fixed event that occurs at a particular point in time	1	2	3	4	5
6. Entrepreneurship is not about greed	1	2	3	4	5
7. Entrepreneurship is mostly about luck	1	2	3	4	5
8. Either a person **is** an entrepreneur or **is not** an entrepreneur	1	2	3	4	5
9. Entrepreneurs are born, not made	1	2	3	4	5
10. Entrepreneurship is structured and well-organized	1	2	3	4	5
11. Entrepreneurship does not require a lot of money	1	2	3	4	5
12. Entrepreneurs try to do as much as they can themselves, seldom relying on others	1	2	3	4	5
13. Entrepreneurship is about starting and running a business	1	2	3	4	5

Do you now, or have you ever in the past, considered yourself to be an entrepreneur?

☐ Yes ☐ No

If you answered “Yes” to the question above, how successful do you consider your entrepreneurial experience overall?

(If “No” leave blank)

- ☐ Very Successful
- ☐ Moderately Successful
- ☐ Neutral
- ☐ Moderately Unsuccessful
- ☐ Very Unsuccessful

How likely are you to engage in any entrepreneurial ventures in the future?

- ☐ Very Likely
- ☐ Somewhat Likely
- ☐ Unsure
- ☐ Somewhat Unlikely
- ☐ Very Unlikely

How many years of managerial work experience do you have? _______ years

How old are you? _______ years

What is your current cumulative grade point average? _______

How many years of full-time work experience do you have? _______ years

How many years of part-time work experience do you have? _______ years

A STUDY ON SELF-MONITORING AMONG SERVICE AND TECHNICAL ENTREPRENEURS

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ABSTRACT

Structural changes in the economy and the advancement in technology have resulted in reduced opportunities for employment. Larger enterprises and government organizations are shifting focus towards self-employment and small firms as important sources of new jobs. Entrepreneurship has a vital role to play in creating those jobs. The rapid economic changes call for a high degree of entrepreneurship, which will help to cushion adverse social impacts of unemployment by facilitating the creation of new employment opportunities as old ones decrease.

Research has demonstrated that the increasing importance of the contribution of firms engaged in technology and services based on both creation of employment and development of innovative practices. ***.*** *It is postulated to study the two types of entrepreneurs' viz. service and technical using a personality variable. It facilitates to further the understanding about the individual behind these ventures and* *the determining factors that go into choice of a particular type of venture.*

Seventy (70) Service and 92 Technical entrepreneurs completed the 13 item Self-monitoring scale on a four point rating scale along with it the profile of the entrepreneurs was also formulated. Further, the mean Self-monitoring scores of the Service and Technical entrepreneurs were compared. It was found that Service entrepreneurs score significantly higher than the Technical entrepreneurs. The implications of the results are discussed in detail.

INTRODUCTION

Entrepreneurs are essential agents of change in a market economy, fuelling the drive for the increasingly efficient use of resources and facilitating trade between parties with different preferences and competencies. Entrepreneurial behavior is likewise a key to accelerating the generation, dissemination and application of innovative ideas. The entrepreneur is therefore the architect of innovation, and societies that wish to foster innovation (either low or high technology) must create an environment conducive to the entry and maintenance of entrepreneurs and the associated small new ventures that they produce.

Structural changes in the economy and the advancement in technology have resulted in reduced opportunities for employment. Larger enterprises and government organizations are shifting focus towards self-employment and small firms as important sources of new jobs. Entrepreneurship has a vital role to play in creating those jobs. The rapid economic changes call for a high degree of entrepreneurship, which will help to cushion adverse social impacts of unemployment by facilitating the creation of new employment opportunities as old ones decrease.

THE ENTREPRENEUR

The entrepreneur is viewed as someone who assumes the social, psychological, and financial risks necessary to start and run a small business (Hisrich & Peters, 1992). A more prominent position to the entrepreneurial figure is identified by four basic responsibilities: a) Collecting, processing and evaluating economic information; b) the execution of essential calculations; c) the stimulation of the production process; and d) control of the above mentioned process under the most auspicious economic conditions. From this vantage point, it seems clear that Menger (1994) envisages the entrepreneur fundamentally as a calculator, organizer or controller.

The entrepreneur performs the role of a manager and possesses a certain psychological capacity, to stimulate (or 'boost') entrepreneurial organization. In fact, the entrepreneur can be differentiated into two types: a) the 'management entrepreneur' who serves a routine, directorial function; and b) the innovative entrepreneur, coinciding in many ways with Schumpeter's vision, who can employ the necessary methods in order to create and steer a firm which has profitable opportunities in the market or in the function of production (Leibenstein, 1995).

ENTREPRENEURIAL TYPES

Typologies on entrepreneurs are aimed at either imaginative or subjective classifications and descriptions.

(Danhof, 1949). Based on the evolution of the firm entrepreneurs were classified into Administrative and Independent entrepreneurs (Collins & Moore, 1964). The classification of entrepreneurs through empirical endeavor resulted in opportunistic and craft entrepreneurs. Which further Resulted in the conclusion that entrepreneurial types are not homogenous but heterogeneous. Significantly, the understanding of cross section of various types of entrepreneurs would facilitate the saying 'right man for the right job'. Alternatively 'right type of entrepreneur for right type of enterprise' (Smith, 1967). On further investigation it was reported that opportunistic entrepreneurs were found most often among entrepreneurs than Craft entrepreneurs (Gilmore, 1971). Alter-natively, craft entrepreneurs represent the individuals who work in an organization carrying out the technical function.

Libenstein (1970) envisaged managerial and innovative entrepreneurs to denote the former to carry out routine directional function, while the latter to employ the necessary methods in order to create and steer a firm, which has profitable opportunities in the market or in the function of production. While Based on certain psychological variables Hundal (1971) distinguished Fast Pro-gressive Entrepreneurs (FPE) form Slow Progressive Entre-preneurs (SPE). Swayne and Trucker (1973) classified entrepreneurs into three-fold classification referring to as Innovative, Modest Risk Taker and Growth Oriented entrepreneur. The personality and biographical characteristics significantly differentiated one set of entrepreneurs from the other (Scanlan, 1979).

Based on the nature of business entrepreneurs are categorized into Cantillon entrepreneur, Industry maker, Administrative entrepreneur, Small Business Owner Operator and Independent entrepreneur (Webster, 1977). Moulik, Patel and Basu (1978) grouped entrepreneurs into three broad categories, as manufacturing, processing and trade or service, these groups require three different sets of traits for their success. (Vesper, 1980) classified entrepreneurs into 11 different types, and pointed out that each of these can be further subdivided. His divisions include: solo self-employed individuals, team builders, independent pattern multipliers, economy-of-scale exploiters, capital aggregators, acquirers, buy-sell artists, conglomerators, speculators, and apparent manipulators. Business owner-managers who use their capital to establish business are classified as self-employed, small employer, owner-controller and owner director (Scase & Goffe, 1982). Using empirical data entrepreneurs were classified into First Generation Entrepreneurs (FGE) and Second Generation Entrepreneurs (SGE). The FGE were reported to be significantly different from SGE on a host of biographical characteristics like, the propensity to adopt innovations, the personality characteristics, and the perception of self-concept and show significant difference and distinguish one from the other (Venkatapathy, 1983; 1984; 1985).

Growing research effort has been devoted to serial or habitual entrepreneurs. Given that entrepreneurship may involve the purchase of an existing business as well as the formation of a new one (Cooper & Dunkelberg, 1986). Using a qualitative examination of the general occupational experience of the technical entrepreneur in the innovation process at previous companies worked for, the individual technical entrepreneurs are classified into four broad categories, namely 'research', 'producer', 'user' and 'opportunist' technical entrepreneur (Jones-Evans, 1995a;

Jones-Evans, 1994a; Jones-Evans & Steward, 1991). In relation to specific skills possessed by entrepreneurs are classified into four types as a) The personal achiever entrepreneur b) The emphatic supersalesperson entrepreneur c) The real manager entrepreneur and d) The expert idea generator entrepreneur (Miner, 1997).

SERVICE AND TECHNICAL ENTREPRENEURS

Entrepreneurship emphasizes on economic development. Research has demonstrated the increasing importance of the contribution of firms engaged in technology and services based to both creation of employment and development of innovative practices. The profile of the Service entrepreneurial type reveals that they are aggressive and at the same time compliant (Prasanna & Venkatapathy, 1999). This is due to the fact that Service entrepreneurs are expected to be aggressive in promoting their services but at the same time the customer expects a compliant behavior while receiving the services. The high degree of competitive environment and the higher percentage of failures in the service industry require the entrepreneurs to exhibit a higher level of achievement orientation and self-esteem. Whereas, the Technical entrepreneur who is often not in direct contact with the customer and who has a strong belief in his own skills for the success of his venture exhibits higher detached behavior and personal control orientation. The technical entrepreneurs demonstrate a lower achievement and self-esteem (Prasanna, 1999). In an environment of large-scale customization, high technology, short cycle times, diverse customer requirements, vast consumer knowledge, overnight obsolescence, and global competition, an increasing percentage of processes are beyond the ability of a single individual to master, resulting in lower achievement and self-esteem orientation. The contribution of Technology and Service based firms to the economy has been highlighted in series of studies. However, dearth of research evidence necessitated this research endeavor to find out the similarities or differences among an emerging and growing entrepreneurial research viz., entrepreneurial cross sections.

It is postulated to study the two types of entrepreneurs' viz. service and technical using a personality variable. To further the understanding about the individual behind these ventures and the determining factors that go into the choice of a particular type of venture, the present research has been commissioned.

SELF-MONITORING

Almost everyone attempts to regulate his or her own non-verbal behavior on occasions. This does not imply that all persons will attain equal success. On the contrary, it is clear that in this respect large individual differences exist and influence social interactions. One of the characteristics that has received growing attention is self-monitoring (Snyder, 1987). Self-monitoring refers to a cluster of characteristics closely related to the ability to adapt one's behavior to current social situations. Persons high in self-monitoring might be described as social chameleons; they can readily adjust their social behavior to demands of given situation. In contrast, a person low in self-monitoring tends to show a high degree of consistency. He or she maintains a consistent non-verbal expression across a wide range of situations.

Self-monitoring has shown strong positive relationships to interpersonal competence (Athay & Darley, 1981), organizational success (Sypher & Sypher, 1983), and career success (Snyder & Campbell, 1982) and High self-monitors, in comparison to low self-monitors, appear to perform better in boundary-spanning jobs that require sensitivity to social cues (Caldwell & O'Reilly, 1982), resolve conflicts through collaboration and compromise (Baron, 1989), receive more promotions (Kilduff & Day, 1994), and emerge as leaders of small groups (Ellis & Cronshaw, 1992; Kent & Moss, 1990; Zaccaro, Foti, & Kenny, 1991).

HYPOTHESIS

The dearth of studies relating to service and technical entrepreneurial types on their personality has resulted in formulation of the null hypothesis that:

> Service and Technical entrepreneurs would remain homogenous on their scores on self-monitoring.

INSTRUMENTATION (SELF-MONITORING SCALE)

The Revised Self-Monitoring Scale, developed by Lennox and Wolfe (1984), was used as the measure of self-monitoring among the entrepreneurial types. This instrument contains 13 Likert-type scaled items, (1 always false; 4 always true) designed to assess the two components of self-monitoring: (a) sensitivity to expressive behavior of others (6 items) and (b) ability to modify self-presentation (7 items). Self-monitoring is considered as a continuous variable, in contrast to scales developed by Snyder (1974) and Snyder and Gangestad (1986) in which responses to true-false questions are used to place respondents into dichotomous categories of high and low self-monitors. Eleven (11) items were scored in the direct method while 2 items were scored in the reverse direction. Responses to items are summed to yield scores for the total Revised Self-Monitoring Scale and for the sensitivity and modifiability subscales. Reliability coefficients in this study were .55 for the sensitivity subscale, .54 for the modifiability subscale, and .71 for the overall scale.

Validity

The item sum correlation method was used in validating the scale. High and low groups were formulated and the individual and the total scores were correlated. Using the difference between the Z scores the discrimination between the groups was worked out by the standard error difference. The C.R. value has been taken into consideration for determining the validity of the items. Only values above 1.96 were considered valid, the scale has adequate validity as shown by the validation technique.

Reliability

Using the split-half method (Prasanna & Venkatapathy, 1999) reported the following reliability coefficients of the self-monitoring scale, .47 for the sensitivity subscale, .45 for the modifiability subscale, and .60 for the overall scale.

SAMPLE

Two hundred respondents were marked out from the list of entrepreneurs registered with the District Industries Center (DIC) Coimbatore. Snowball sampling technique was used to select the respondents based on their nature of business and investment in plant and machinery (10 lakhs to 100 lakhs of rupees). The respondents selected were involved in service/technology related business. The sample consisted of a matched sample of 100 respondents belonging to the entrepreneurial types mentioned. The sample consisted of respondents representing the various parts of Coimbatore district. The researcher approached the respondents individually and after explaining the purpose of the visit collected information from the respondents using the instruments earmarked for the purpose of the present study. Twenty-two respondents were unwilling to respond to the research process and 16 respondents provided incomplete information. Thus, the final sample consisted of 162 respondents consisting of 70 service entrepreneurs and 92 technical entrepreneurs.

RESULTS & DISCUSSION

Biographical Profile

The service and technical entrepreneurs differ between themselves on a series of biographical characteristics. The service entrepreneurs are younger compared to the technical entrepreneurs. Possibly, it may be due to the reason that the service-oriented industries have gained importance during the recent times. The entries into these types of industries are also recent. Less number of service entrepreneurs were married compared to technical entrepreneurs. This can be because of the age factor and the time required by them to establish their ventures. Higher number of service entrepreneurs displayed an urban background, since services play a prominent role in the urban areas, resulting in enhanced awareness about service industries. With regard to the educational qualifications, the technical entrepreneurs have a higher level of education specifically, technical education. Since, the successes of the ventures are directly related to the technical competence of the entrepreneurs. The work experience patterns of the entrepreneurial types reveal that service entrepreneurs possess lesser number of years of experience. Since, the type of enterprises they venture into require more off- job skills compared to the technical entrepreneurs. The technical entrepreneurs have started more new ventures than the service entrepreneurs have, since they have entered the industry at a much earlier stage. Further the scope to start a related ancillary or feeder industries are higher. The service entrepreneurs need to invest higher capital due to the variety of the service ventures that call for better and effective logistic management. The industries' orientation towards services has resulted in higher returns. Probably this could be one of the reasons for the service entrepreneurs to project a higher turnover compared to the technical entrepreneurs. The pattern with regard to the number of employees shows that technical entrepreneurs employed a higher number of workers since many of these ventures are labor intensive. Technical entrepreneurs choose more complex ventures compared to service entrepreneurs due to the venture requirements and complex production and operation functions. Anuradha Basu (1998) in a study on entrepreneurial activity among Asian small business in Britain reported that previous experience in current business (35.9%) and easy kind of business to enter/run (28.2%) are the two major factors that influenced the entrepreneurs to choose a particular line of business. Thus it is seen that there is a possibility of developing distinctive profiles for the two entrepreneurial types.

Table 1 shows the mean, standard deviation and the critical ration for scores on the modifiability subscale of self-monitoring scale among Service and Technical entrepreneurial types

Table 1
Scores on the Modifiability Subscale of Self-Monitoring Scale among Service and Technical Entrepreneurial Types

Scale	Category	N	Mean	S.D.	Critical ratio
Modifiability subscale	Service	70	21.67	2.22	4.14**
	Technical	92	20.04	2.80	

Table 2 shows the mean, standard deviation and the critical ration for scores on the sensitivity subscale of self-monitoring scale among Service and Technical entrepreneurial types

Table 2
Scores on the Sensitivity Subscale of Self-Monitoring Scale among Service and Technical Entrepreneurial Types

Scale	Category	N	Mean	S.D.	Critical ratio
Sensitivity subscale	Service	70	19.23	3.07	2.18*
	Technical	92	18.40	2.92	

*** Significant at .01 level.* ** Significant at .05 level.*

Tables 1 and 2 show the mean, standard deviation and the critical ratio for service and technical entrepreneurs on their scores on self-monitoring. The service entrepreneurs have a higher mean score compared to the technical entrepreneurs on the two subscales of self-monitoring i.e. a) Ability to modify self-presentation & b) Sensitivity to expressive behavior of others. The critical ratios show a statistically significant difference at .01 level for Modifiability subscale and .05 level for the Sensitivity subscale. Hence, the null hypothesis that the entrepreneurial types will remain homogenous on their scores on self-monitoring is rejected. And the alternative hypothesis that the entrepreneurial types remain heterogeneous on their scores on self-monitoring is accepted. This supports the view that Service entrepreneurs are more aggressive and at the same time compliant. Service entrepreneurs are expected to be aggressive in promoting their services but at the same time the customer expects a compliant behavior while receiving the services. Further, the high degree of competitive environment and the higher percentage of failures in the service industry require the entrepreneurs to exhibit a higher level of achievement orientation and self-esteem.

The Technical entrepreneur who is often not in direct contact with the customer and who has a strong belief in his own skills for the success of his venture exhibits higher detached behavior and personal control orientation. An environment of large-scale customization, high technology, short cycle times, diverse customer requirements, vast consumer knowledge, overnight obsolescence, and global competition, an increasing percentage of processes are beyond the ability of a single individual to master resulting in lower achievement and self-esteem orientation. It can be noticed that many of the characteristics associated with high self-monitors have close relevance to service entrepreneurs which have been authenticated by the Service entrepreneurs obtaining a higher mean score on self-monitoring compared to Technical entrepreneurs.

The studies on typology of entrepreneurship have diminishing importance in the current environment since most of the previous types of entrepreneurs have become redundant. The current knowledge revolution has thrown up a different class of entrepreneurs; high technology firms and service firms have turned out to be the major contributors to the economy. Current economies of many countries are influenced by the technology and service based industries. Thus, it is imperative to study the entrepreneurs behind these ventures, so that more entrepreneurs can be trained in accordance.

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APPENDIX

SERVICE ENTREPRENEUR (Prasanna & Venkatapathy, 1999): Initiates and manages small service based firms involved in providing innovative services. The entrepreneurial qualities of the founder are considered to be among the main strengths of the business added to the wealth of market experience that the entrepreneur has developed within the particular industry prior to start-up.

TECHNICAL ENTREPRENEUR (Prasanna & Venkatapathy, 1999): Initiates and manages small technology-based firms involved in introduction of innovative technology into the market. High degree of technical expertise of academic and technical nature characterizes the entrepreneur.

THE REVISED SELF-MONITORING SCALE

Please read the following statements carefully & please record your response as the degree to which you think the following statements are true or false by (a) the appropriate box.

__Always false __Sometimes false __Sometimes true __Always true

	Items	C.R.
1	In social conditions, I have the ability to alter my behavior if I feel that something else is called for.	3.00**
2	I am often able to read people's true emotions correctly through their eyes.	2.66**
3	I have the ability to control the way I come across to people, depending on the impression I wish to give them	2.80**
4	In conversations, I am sensitive to even the slightest change in the facial expression of the person I am conversing with.	2.20*
5	My powers of intuition are quite good when it comes to understanding others' emotions and motives.	2.53*
6	I can usually tell when others consider a joke in bad taste, even though they may laugh convincingly.	2.00*
7	When I feel that the image I am portraying is not working, I can readily change it to something that does.	2.40*
8	I can usually tell when I've said something inappropriate by reading the listener's eyes.	2.86**
9	I have trouble changing my behavior to suit different people and different situations.	3.13**
10	I have found that I can adjust my behavior to meet the requirements of any situations I find myself in.	2.73**
11	If someone is lying to me, I usually know it at once from the person's manner of expression.	2.66**
12	Even when it might be to my advantage, I have difficulty putting up a good front.	3.20**
13	Once I know what the situation calls for, it is easy for me to regulate my actions accordingly.	2.40*

*** Significant at .01 level.*   ** Significant at .05 level.*

RATE OF BUSINESS FAILURES: AN ANALYSIS OF THE DETERMINANTS

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ABSTRACT

The prospect of business failure is of significant concern to the entrepreneur as a number of findings suggest that many new businesses end in failure. While there has been speculation about how and which factors are related to business failure, little systematic work has been done to tease apart the various factors which potentially impact business failure. Based on annual data compiled from 1959 to 1996, we use regression analysis to relate business failures to the unemployment rate of experienced wage and salary workers, the gross domestic product, the Federal funds interest rate, and the ratio of profits after Federal income taxes to stockholders' equity for all manufacturing corporations. Moreover, we examine the long-run, as well as the short-run, impact of the determinants of business failures and suggest that many business ventures end in failure because of

"outside" economic factors rather than problems specific to the manager.

INTRODUCTION

Business failure has long been recognized as among the most serious issues confronting small business. A prospective entrepreneur faces daunting odds – the typical new business ends in failure (Lane & Schary, 1991). In fact, widespread discussion recently has evolved into a robust advice and analytical industry devoted to defining and describing the characteristics and expertise required of small businesses. Specifically, entrepreneurs are advised to undertake prescribed procedures to decrease the likelihood of failure (Gerber, 1998; 1999).

Why do so many small business failures occur and what can be done to prevent them? Indeed, *can* business failures be prevented? Much of the discussion in the entrepreneurship literature focuses upon the individual entrepreneur and factors such as managerial inexperience, poor planning, inadequate cash reserves, and the like (see Dun & Bradstreet, April 21, 1999; U.S. Small Business Administration, 1998). To the extent that such factors are the primary determinant of business failure, better preparation of the prospective entrepreneur could do a great deal to prevent these closings (Lussier, 1996). Supporting this argument are situations where an increase in business failures follows from an increase in the number of new firm start-ups. For example, the rate of business failures increased dramatically in the mid-1980s, a time which marks the longest continuous expansion in the United States' economy since World War II and a period of exceptionally heavy new business expansion.

However, there is an equally compelling argument that business failures may result from economic factors which are operating at much more macro levels and which may be completely out of the hands of the entrepreneur. The general public, and many entrepreneurs as well, have come to associate the rate of business failures with the overall strength of our economy. Stemming from experiences such as the heavy rate of failures accompanying the Great Depression, there has been a widespread belief that an increase in business failures is indicative of a weakness in the economy. If this is the case, the connection between business failures and recessions is probably causal, with a poor economy causing failures, for example, and increasing failures fueling further economic problems. Where economic factors are primary contributors, the entrepreneur may have much less control of the issues leading to failure.

In this study, we look specifically at economic factors and attempt to determine how closely they relate to business failure. Specifically, we develop regression models which use economic factors to explain the rate of business failure. To the extent that economic factors account for a large proportion of the variance in the failure rate, we maintain that it is these factors, and not primarily managerial factors, which account for the high rate of small business failure. We next consider how the literature has considered these factors.

UNDERSTANDING BUSINESS FAILURES: MANAGERIAL VS ECONOMIC FACTORS

What exactly are business failures? Dun and Bradstreet (1998) (which is considered the primary source of data on the business failure rate) defines business failures as those businesses that ceased operation following assignment or bankruptcy. Similarly, Archibald and Baker (1988) define business failures as "firms that cease to exist and leave unpaid debts" (p. 221). Lane and Schary (1991) report that "business failures are either the exit of businesses involved in court proceedings or the exit of business by voluntary actions involving losses to creditors" (p. 95).

What *causes* the failures? In 1971, Altman concluded that at least 90 percent of business failures were due to internal sources such as incompetence, neglect, and a lack of experience. Likewise, Platt (1985) found that 88 percent of business failures in 1981 could be attributed to insufficient line experience, inadequate managerial expertise, and incompetence, and DiBernardo (1999) reported similar findings in a survey conducted in 1999 for Dun and Bradstreet. As noted, increased numbers of business startups during economic expansion, as occurred in the mid-1980s, might also lead to accelerated rates of business failures. Moreover, Phillips and Swain (1985) indicated that much of this phenomenon probably relates to managerial inexperience and inadequate financing rather than economic conditions. Certainly, these ideas suggest factors which are unrelated to economic conditions.

Nevertheless, there are many suggestions which focus on more macro-level causes of business failures. Archibald and Baker (1988) concluded that determinants of business failures include weaknesses in companies' balance sheets and Federal credit activities such as errors in aggregate net revenue and credit availability. Furthermore, Williamson (1987) reported that high unemployment and a rise in the number of loans can be associated with an increase in the rate of business failures.

In this study we present a somewhat distinctive approach to the process of examining causes of business failure. Instead of the more conventional approaches, which tend to concentrate on internal causes, our focus is upon the relative strength of key macro-level economic factors -- the unemployment rate, the gross domestic product, the Federal funds interest rate, and the ratio of profits to stockholders' equity -- to determine their impacts upon business failures. We also examine both the long-run and short-run impact of these potential determinants of business failures.

METHODS

In this study, we report results for a model incorporating five potential determinants of the rate of business failures. Our model is expressed below.

We expect that BFAIL will be positively associated with UR2 and INT and negatively correlated with GDP and PROF. Our discussion of economic impacts suggests that it is reasonable to suppose, for example, that as the unemployment rate increases, the rate of business failures also will grow (Williamson, 1987). The sign for interest rates (INT) is expected to be positive because as needed capital becomes increasingly difficult to acquire, business failures are expected to increase. On the other hand, the sign of GDP is expected to be negative because as the gross domestic product multiplies, business failures can be expected to decline. Similarly, as business profits increase, the rate of business failures can be expected to decrease.

BFAIL = f(UR2, GDP, INT, PROF, BFAIL1)

where

BFAIL = the business failure rate per 10,000 listed enterprises;
UR2 = the unemployment rate which includes only experienced wage and salary workers
GDP = the gross domestic product
INT = the Federal funds interest rate
PROF = the ratio of profits after Federal income taxes to stockholders' equity for all manufacturing corporations
BFAIL1 = ($BFAIL_{t-1}$) the lagged dependent variable which expresses the long-run impact of the right-hand-side variables.

DISCUSSION

Sample

Our sample consisted of annual observations from 1959 to 1996. A lagged dependent variable was used, thus reducing the number of observations employed in calculations by one. The data was collected from *The Economic Report of the President* (1998) and is displayed in Appendix A.

Regression

Before continuing the discussion, the issue of functional form of the regression model should be addressed. Several possible functional forms of regression, including linear, double-log, and semi-log were available and were tested. While both semi-log regressions had significant intercepts, one semi-log regression had a negative intercept and the other regression had many insignificant right-hand-side variables. Because the significance of the determinants vary depending upon the model presented, both the linear form and the double-log form will be presented in this paper. In this study, we use regression analysis, treating our proposed factors as independent variables and business failure as our dependent variable.

Linear Regression

The estimated regression and relevant statistics are reported in Table 1. As shown below, approximately 91 percent of the variation in the rate of business failures can be explained by the five right-hand-side variables. No autocorrelation was found to exist, and the linear regression as a whole was significant at the one percent level. Moreover, all of the coefficients have the expected signs. It should be noted that unemployment rate was significant at the five percent level, interest rate was not significant (10 percent level), and the ratio of profits to stockholders' equity was significant at the one percent level. Interestingly, it was found that in the linear model, gross domestic product was not significant (10 percent level).

Table 1 is generally in line with our expectations. Based on the parameter estimates, if UR2 were to rise by one, the rate of business failures should grow by about 2.468. Likewise, if the interest rate were to increase by one, BFAIL should also increase by about 1.117. Conversely, if PROF were to rise by one, the rate of business failures should decrease by approximately 1.788. The intercept of 11.437 suggests that even if all of the right-hand-side variables were equal to zero, the rate of business failures would still be equal to about 11.437. This finding supports the arguments raised earlier that factors other than the economy are contributors to business failure. Note, however, that the high R^2 for our equation indicates that only about 9 percent of the variance, at best, could be explained by such factors. The lagged dependent variable (BFAIL1) indicates that the long-run impact of the right-hand-side variables is about eight times greater than the short-run impact.

TABLE 1
LINEAR REGRESSION FOR THE RATE OF BUSINESS FAILURES

Variable	Coefficient	t-ratio
Intercept	11.437162	1.090
UR2	2.467815*	2.061
GDP	-1.068153	-1.457
INT	1.116781	2.028
PROF	-1.787633**	-3.156
BFAIL1	0.875465**	16.789
Adjusted R^2	0.9144	

* = significant at the 5% level; ** = significant at the 1% level

Double-Log Regression

The estimated double-log regression and relevant statistics are reported in Table 2. As shown below, approximately 91.5 percent of the variation in the rate of business failures can be explained by the five right-hand-side variables. No autocorrelation was found to exist, and the double-log regression as a whole was significant at the one percent level. All of the coefficients have the expected signs.

It should be noted that the log of the gross domestic product could not be taken because the GDP contained negative numbers. The log of the unemployment rate was not significant (10 % level), the gross domestic product was significant at the one percent level, and the log of the ratio of profits to stockholders' equity was not significant (10 % level). Interestingly, we note that in the double-log model, the log of the interest rate also was not significant (10 % level).

TABLE 2
DOUBLE-LOG REGRESSION FOR THE RATE OF BUSINESS FAILURES

Variable	Coefficient	t-ratio
Intercept	0.319851	0.949
LUR2	0.185771	1.854
GDP	-0.031247**	-2.762
LINT	0.088761	1.630
LPROF	-0.130835	-1.741
LBFAIL1	0.908193**	17.329
Adjusted R^2	0.9167	

* = significant at the 5% level; ** = significant at the 1% level

Table 2 suggests that if UR2 were to rise by one percent, the rate of business failures would grow by around 0.186 percent. Conversely, if PROF were to rise by one percent, LBFAIL would decrease by approximately 0.131 percent, and if GDP were to increase by one, LBFAIL would decrease by about 0.031. Even if all of the right-hand-side variables were equal to zero, the log of the rate of business failures would be equal to approximately 0.320 percent. The log of the lagged dependent variable (LBFAIL1) indicates that the long-run impact of the right-hand-side variables is approximately 10.5 times greater than the short-run impact.

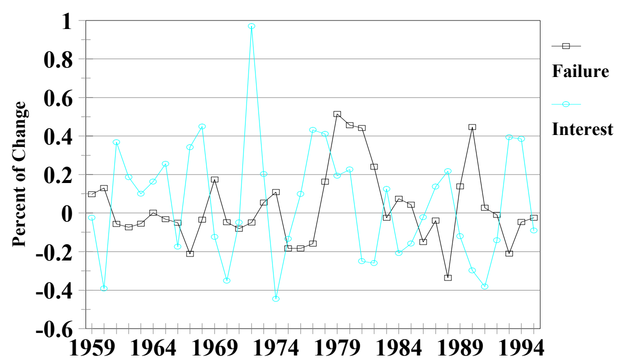
One very important observation is that in the linear regression, GDP is not significant and the interest rate is not significant (10 percent level). However, in the double-log regression, GDP becomes significant at the one percent level while INT is not significant. When the stepwise procedure was performed for the double-log regression, LBFAIL, GDP, and LUR2 were listed as the three best right-hand-side variables. The stepwise procedure was then performed for the linear regression. The variables BFAIL1, UR2, PROF, and INT emerged as the four most important determinants. Consequently, an additional test, the Jp test, was used to help determine the final prediction error (SAS Institute, Inc., 1989). When the Jp test reveals a low or minimum value, it is used because it suggests the "best" model (Hocking, 1976). In this study the Jp test was performed for both the linear and the double-log regressions. In both instances, the lowest Jp number was found using all five independent variables. It is, therefore, reasonable to include all five right-hand-side variables in both regressions.

Three other variables were considered and tested. The first was the unemployment rate, which included all civilian workers (UR1). It was used as a substitute for UR2. The use of this variable was found to be less significant than the unemployment rate of experienced wage and salary workers because UR1 also includes teenage workers whose employment is probably not closely related to the issues under study in this research. The other two variables considered were the composite New York Stock Exchange index (NYSE) and Standard and Poor's composite index (SP500). Originally we speculated that a stock price index would be a significant determinant of the rate of business failures. The signs of both of these variables were expected to be negative. When the data were analyzed, however, the parameter estimates for both variables were positive. Additionally, using either of these variables in the statistical analysis caused the signs to change for other independent variables. Therefore, we determined that it was necessary to perform the Klein's test. The Klein's test requires that the adjusted R^2 of the main regression be computed and compared to all of the adjusted R^2 of the auxiliary regressions. If the adjusted R^2 main < adjusted R^2 auxiliary for any of the comparisons, it indicates that multicollinearity is serious (McClave, Benson, & Sincich (1998). In this instance when the Klein's test was performed, a serious multicollinearity problem was confirmed to exist. Incorporating this data and other information we obtained from the various statistical analyses, we concluded that stock indices simply appear to provide a redundant measure of one or more of the five factors under study.

SUMMARY AND CONCLUSIONS

This study has examined a series of macro-level economic determinants of the rate of business failures. Based on annual data compiled from 1959 to 1996, business failures can be connected to the unemployment rate of experienced wage and salary workers, the gross domestic product, the Federal funds interest rate, and the ratio of profits after Federal income taxes to stockholders' equity for all manufacturing corporations. This study also found that in the years preceding an increase/decrease in the rate of business failures, the interest rate also increased/decreased correspondingly (see Figure 1). The data show that when interest rates change in year one, the rate of business failures usually change either in years two or three. There appears to be a lag period between the change in interest rates and the change in business failure rates (see Appendix B).

Figure 1
Rates of Interest and Business Failure



Interest rates, therefore, have a predictive quality or characteristic in relation to the rate of business failures. In addition, the value of the lagged dependent variable, BFAIL1, demonstrates that the long-run effect of the right-hand-side variables as well as the short-run impact of these variables should be understood and recognized. The value of the adjusted R^2 for both the linear and double-log regressions is slightly greater than 91 percent, which indicates that other potential explanatory variables should be considered, but that by far the most significant impact is from macro-level economic factors.

What are the implications for the entrepreneur? We interpret these findings as indicating that managerial problems may represent a far less important issue in business failure than has been assumed in many instances. Of course, we are not by any means suggesting that managerial issues are unimportant or that solid management is unnecessary to the entrepreneur. Undoubtedly, solid management permits many small businesses to survive in difficult economic periods. Instead, we see these findings as highlighting the importance of economic factors and the need for the entrepreneur to be keenly aware of the strategic risks posed by economic factors. The management literature has historically emphasized the need for the manager to serve as a "boundary spanner," monitoring the environment to permit the organization to move quickly to respond to both opportunities and challenges posed by the environment. Our results indicate that this advice may be doubly needed by the entrepreneur!

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Appendix A

YEARS	BFAIL	UR2	GDP	INT	PROF
1959	51.9	5.7	7.4	3.30	10.4
1960	57.0	5.7	2.4	3.22	9.2
1961	64.4	6.8	2.3	1.96	8.9
1962	60.8	5.6	6.1	2.68	9.8
1963	56.3	5.6	4.3	3.18	10.3
1964	53.2	5.0	5.8	3.50	11.6
1965	53.3	4.3	6.4	4.07	13.0
1966	51.6	3.5	6.5	5.11	13.4
1967	49.0	3.6	2.5	4.22	11.7
1968	38.6	3.4	4.7	5.66	12.1
1969	37.3	3.3	3.0	8.20	11.5
1970	43.8	4.8	0.1	7.18	9.3
1971	41.7	5.7	3.3	4.66	9.7
1972	38.3	5.3	5.5	4.43	10.6
1973	36.4	4.5	5.8	8.73	12.8
1974	38.4	5.3	-0.6	10.50	14.9
1975	42.6	8.2	-0.4	5.82	11.6
1976	34.8	7.3	5.4	5.04	13.9
1977	28.4	6.6	4.7	5.54	14.2
1978	23.9	5.6	5.4	7.93	15.0
1979	27.8	5.5	2.8	11.19	16.4
1980	42.1	6.9	-0.3	13.36	13.9
1981	61.3	7.3	2.3	16.38	13.6
1982	88.4	9.3	-2.1	12.26	9.2
1983	109.7	9.2	4.0	9.09	10.6
1984	107.0	7.1	7.0	10.23	12.5
1985	115.0	6.8	3.6	8.10	10.1
1986	120.0	6.6	3.1	6.81	9.5
1987	102.0	5.8	2.9	6.66	12.8
1988	98.0	5.2	3.8	7.57	16.1
1989	65.0	5.0	3.4	9.21	13.6
1990	74.0	5.3	1.2	8.10	10.7
1991	107.0	6.6	-0.9	5.69	6.3
1992	110.0	7.2	2.7	3.52	2.2
1993	109.0	6.6	2.3	3.02	8.1
1994	86.0	5.9	3.5	4.21	15.9
1995	82.0	5.4	2.0	5.83	16.1
1996	80.0	5.2	2.8	5.30	16.8

Appendix B: Percentage Change in Interest Rates vs Business Failure Rates

Years	Interest Rate	Failure Rate	% Change in Interest	% Change in Failure
1959	3.30	51.90	-0.02424	0.09827
1960	3.22	57.00	-0.39130	0.12982
1961	1.96	64.40	0.36735	-0.05590
1962	2.68	60.80	0.18657	-0.07401
1963	3.18	56.30	0.10063	-0.05506
1964	3.50	53.20	0.16286	0.00188
1965	4.07	53.30	0.25553	-0.03189
1966	5.11	51.60	-0.17417	-0.05039
1967	4.22	49.00	0.34123	-0.21224
1968	5.66	38.60	0.44876	-0.03368
1969	8.20	37.30	-0.12439	0.17426
1970	7.18	43.80	-0.35097	-0.04795
1971	4.66	41.70	-0.04936	-0.08153
1972	4.43	38.30	0.97065	-0.04961
1973	8.73	36.40	0.20275	0.05495
1974	10.50	38.40	-0.44571	0.10938
1975	5.82	42.60	-0.13402	-0.18310
1976	5.04	34.80	0.09921	-0.18391
1977	5.54	28.40	0.43141	-0.15845
1978	7.93	23.90	0.41110	0.16318
1979	11.19	27.80	0.19392	0.51439
1980	13.36	42.10	0.22605	0.45606
1981	16.38	61.30	-0.25031	0.44209
1982	12.28	88.40	-0.25977	0.24095
1983	9.09	109.70	0.12541	-0.02461
1984	10.23	107.00	-0.20821	0.07477
1985	8.10	115.00	-0.15926	0.04348
1986	6.81	120.00	-0.02203	-0.15000
1987	6.66	102.00	0.13664	-0.03922
1988	7.57	98.00	0.21664	-0.33673
1989	9.21	65.00	-0.12052	0.13846
1990	8.10	74.00	-0.29753	0.44595
1991	5.69	107.00	-0.38137	0.02804
1992	3.52	110.00	-0.14205	-0.00909
1993	3.02	109.00	0.39404	-0.21101
1994	4.21	86.00	0.38480	-0.04651
1995	5.83	82.00	-0.09091	-0.02439
1996	5.30	80.00	-------------	-------------

FRAUD: A CONCOMITANT CAUSE OF SMALL BUSINESS FAILURE

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ABSTRACT

This paper presents evidence to support a new perspective: the majority of small businesses fail because of fraud. Fraud occurs in small firms at 100 times the rate for large firms, and the overwhelming majority of frauds are committed by honest employees who have a perceived need, recognize an opportunity, perceive the probability of detection as low, and have the ability to rationalize their behavior. The authors present a plan for dramatically reducing fraud; one which does not increase costs or rely upon accountants, and which can be implemented by any small business. The best deterrence is fear of social sanction: i.e., the loss of the respect of one's peers. The proposed plan creates a climate in which these sanctions will prevail.

INTRODUCTION

Small business failure is one of the most serious economic problems in the United States. If one had the solution to the problem, one would have the power to wipe out unemployment, revitalize downtown areas, eliminate trade deficits, and give the economy such a boost that it would carry the nation into the *third* millennium, all with a single wave of the magic wand. No one has such a solution, but that may be because no one is willing to recognize the cause. The study of small business failure has been so institutionalized, that the causes of failure have become clichés: managerial incompetence, undercapitalization, etc. These antecedents of failure are so endemic to the process of entrepreneurship that they appear to be insoluble.

What if the traditional perspective is flawed? What if there is another factor which has gone unrecognized and which actually precipitates the majority of small business failures? What if this factor is not only vulnerable, but soluble? If so, then everything changes and small business failure is no longer a sad, but inevitable fact of entrepreneurial life; it is a plague which can be attacked, mitigated, perhaps even eliminated.

This paper will present a new perspective of small business failure: *the majority of small businesses fail because of fraud.* The authors will examine the traditional perspective and present evidence to support their position. The paper will close with a plan for dramatically reducing fraud in a small business setting; a plan which does not drive up costs or rely upon accountants and auditors, and a plan which can be implemented by any small business owner.

LITERATURE REVIEW

Hambrick and D'Aveni (1988) found that the process of failure in large corporations is a long downward spiral. Perhaps that conclusion is true for large businesses, but small businesses do not follow the time frame of a multi-million dollar company, but rather they experience failure swiftly and finally. Among the studies which support the more cataclysmic nature of small business failure is Venkataraman, Van de Ven, Buckeye, and Hudson (1990) who identified ten companies which developed educational software and followed their progress from 1983 to 1984, a year of turbulence within the computer industry. Six of the ten companies experienced cash flow problems during that time period, and 40% obtained new equity or long-term debt during 1984, although the additional capital did not usually solve their cash flow problems. All six firms underwent dramatic turnarounds, and the study concluded, at least for small firms operating in a turbulent environment, that failure is catastrophic, not downward spiraling.

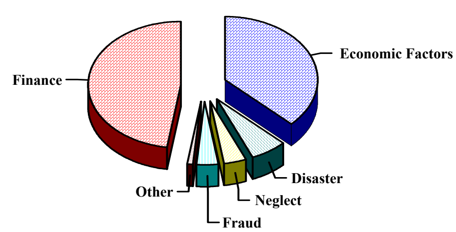
One of the primary reasons for sudden failure is the smallness of the firms themselves. Bradley and Rubach (1999) suggested that the liability of smallness, in fact, carries its own potential for failure as smallness translates into a lack of sufficient financial resources. They found that leveraging had a negative effect on business success, and demonstrated that the majority of small firms borrow substantial sums to operate their businesses. The inescapable conclusion is that small firms, by their very nature, have shallow pockets and high debt levels. Consequently, small business failure is meteoric. In our view, this is one of the primary reasons that the phenomenon is misunderstood: it happens so fast that almost no one knows what caused the collapse.

The traditional view is quite different. A number of studies of the phenomenon have been conducted and their findings are well known among entrepreneurship researchers. Some of the more salient contributors to failure which researchers have identified include cash crises (Dun & Bradstreet, 1981), inability to manage rapid growth and change (Hambrick & Crozier, 1985), lack of experience to deal with turbulence in the specific industry (MacMillan, Siegel, & Subba Narasimha, 1985; Vesper, 1980; Cooper & Bruno, 1977; Wyant, 1977) an incomplete startup team (Roure & Maidique, 1986), inadequate pre-start-up and post-start-up planning by the entrepreneurs (Robinson & Pearce, 1983; Chambers & Golde, 1963; Trow, 1961; Christensen, 1953; Woodruff & Alexander, 1958), a lack of motivation and commitment (Van de Ven, Hudson, & Schroeder, 1984), improper choice of niche strategy (Khan & Rocha, 1982), the lack of legitimacy (Singh, Tucker & House, 1986), an increase in the level of competitiveness in the niche (Roure & Maidique, 1986), and the volatility of the business cycles (Carroll & Delacroix, 1982).

The most pervasive factors in small business failure may be undercapitalization and record keeping. In a study of twenty-six paired firms, thirteen designated as successful and thirteen designated as unsuccessful, Duchesneau and Gartner (1990) found that the less successful firms tended to be undercapitalized. Lussier (1996) found that businesses which start from an undercapitalized position have a greater chance of failure than firms that start with adequate capital, and that businesses which do not keep updated and accurate records and which do not use adequate financial controls have a greater chance of failure than those that do. Of the twenty-two studies which he cites as comparable, eight identified both capital and record keeping/financial control as factors related to failure (Bruno, Leidecker, & Harder, 1987; Dun & Bradstreet, 1995; Flahvin, 1985; Lauzen, 1985; Reynolds, 1987; Reynolds & Miller, 1989; Vesper, 1990; Wight, 1985). Gaskill, Van Auken and Manning (1993) and Wood (1989) also cited record keeping as a variable predictive of failure. Bradley and Rubach (1999) noted that the failure to keep records current was a factor in 35% of the collapses they studied; an error which others have recognized as a contributor to small business failure (Hodgetts & Kuratko, 1998; Argenti, 1976).

In short, the traditional thinking is that most business failures are a function of managerial, financial or economic problems. Fraud plays but a minor role in the general understanding. Exhibit 1 displays one well established perspective of business failures (Dun & Bradstreet, 1993): fraud accounts for less than 4% of business failures.

Exhibit 1
Causes of Business Failure



THE FRAUD EPIDEMIC

Fraud is defined by Black's Law Dictionary as:

> *"All multifarious means which human ingenuity can devise, and which are resorted to by one individual to get an advantage over another by false suggestions or suppression of the truth. It includes all surprise, trick, cunning, or dissembling, and any unfair way which another is cheated" (Black, 1979, 468).*

Applying that definition to business activities, one finds that fraud is the primary factor in *white collar crime*. Edwin Sutherland, who coined the term *white collar crime* in 1939, used it to mean the criminal acts of corporations and individuals acting in their corporate capacities (Wells, 1997). These acts almost always involve fraud.

White collar crime may be the most serious and yet most the most under-recognized problem in the United States today, especially for small businesses. One of the best estimates of fraud losses ever prepared suggests that the average business in America loses six percent of gross revenues to fraud (Wells, 1997, p. 35). If we apply that ratio to the United States Gross Domestic Product, then annual fraud losses exceed *$400 billion*. That sum is vastly larger than the total budget for the Department of Defense. Furthermore, the annual losses are growing. If the estimate is even remotely accurate, consider the impact on American firms, especially small firms. First, losses on that scale greatly impede competitiveness, especially with foreign competitors. Secondly, such losses contribute to declines in efficiency and effectiveness, leading to lay offs and downsizing. Third, losses of this magnitude mean that prices are dramatically overstated throughout the economy. Finally, such losses mean an increase in the failure rate, especially for small and start up firms.

Crime has been present in our society since the beginning of time, however, in recent years, there has been an increasing trend toward white collar crime. In fact, the cost of insurance fraud alone is estimated at over $100 billion per year (Beddingfield, Hawkins, Ito, Lenzy & Loftus, 1996). The number of investment fraud cases pursued by the Securities and Exchange Commission has risen 60% in the past five years (Beddingfield, et al., 1996). Clearly, the scale of the problem is staggering. It dwarfs the financial losses from all other sources of crime.

The situation may well worsen. In a recent television interview, Salvatore, Sammy the Bull, Gravano, the former second in command to John Gotti, former top mafia godfather in the United States, discussed the changes in the modern mafia. The old mafia, trafficking in drugs, prostitution, gambling and racketeering is rapidly changing. The new mafia elite are specialists in fraud, embezzlement, and white collar crime (Gravano, 1997). Thus, the new mafia is recognizing how much easier and more lucrative it is to steal with a computer than with a gun. With the mafia entering the scene, one can expect other professional criminals to follow their lead. If losses have been so great when amateurs were the primary culprits, consider how much more serious the problem will become with professionals leading the way.

Just how much employee fraud occurs in the United States? Determining the actual amount of fraud is impossible because it is a crime which is seldom reported and even more infrequently prosecuted. One study estimated that more than 75% of white collar crime goes unreported (Doost, 1990). To deal with this issue, the Association for Certified Fraud Examiners undertook a massive, multi-year study of the problem. The Association surveyed 10,000 fraud examiners around the country and established a 26% response rate (Wells, 1997). The report drawn from that research has come to be called the Wells Report and it constitutes the most comprehensive study of employee fraud yet conducted. Among the specifics concerning actual instances of employee fraud, the survey asked for opinions from this panel of experts with regard to the scale of the problem. Their estimate, noted above, was 6% of gross revenues, coupled with an even more staggering position that two of three employees in America are stealing at least something from their employers (Wells, 1997).

The scale of the problem on an individual firm level results in even greater insight. The average loss for small firms, those with less than 100 employees, was $120,000 per firm, almost exactly the same amount as for large firms, those with 10,000 or more employees. This means that small firms experience fraud *at nearly 100 times the rate* of large firms (Wells, 1997). The most frequent fraud discovered in the Wells Report and probably in the nation as a whole is a fraud committed by an accounting clerk in a small business. How many small firms can absorb a loss of $120,000 and survive? The answer is not one which offers any encouragement with regard to the survival rate of small businesses.

It is our belief that the situation for small firms is even worse. As noted above, experts believe that 75% of fraud goes unreported (Doost, 1990). In the case of small firms, we believe that this ratio is *grossly understated*. Small firms are the least likely to have any sort of internal controls in place, are the least likely to engage in any sort of external review or audit, are the least likely to have current records, and almost never have internal auditors. Consequently, most small businesses *cannot determine* when fraud has occurred, at least not for an extended period of time. Given that small business failure tends to be sudden and final, that implies that fraud in small firms which results in their failure is almost never detected.

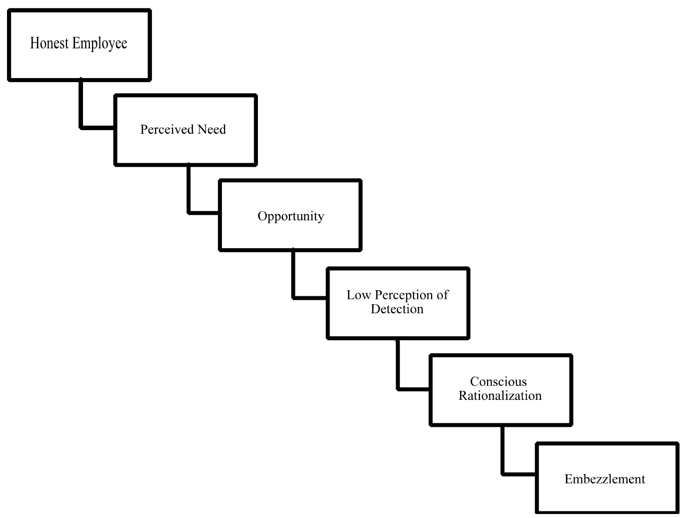
The authors have consulted with more than 400 small firms over the last 20 years. Anecdotally, the owners of those firms were almost always engaged in dubious accounting and financial activities which were designed to reduce income tax liabilities. Specifically, this involved removing funds from taxable status though a variety of means, most of which accountants and tax representatives would consider to be fraudulent. These actions distorted the financial status of the firms and made it difficult to determine the true state of financial health of the businesses involved. The actions also made it difficult, impossible in many cases, to determine whether any other employees of the business might be involved in embezzlement or other fraudulent acts. Thus, the authors are convinced that the proportion of fraud recognized in small firms is much less than the overall average.

In our view, less than 10% of frauds in small firms are reported or even recognized. If our perspective of the ratio of fraud recognition is valid, then the actual proportion of frauds involved in contributing to business failures is vastly larger: *the majority of small business failures may result from fraud*. In our view, the overwhelming majority of fraud losses are *disguised* as *managerial, economic, financial* or *capitalization* problems.

WHO COMMITS FRAUD?

Many people find the answer to this question surprising, because the vast majority of people who commit fraud are not criminals. They look and act just like our neighbors and friends because they *are* our neighbors and friends. Both men and women commit fraud, both young and old commit fraud, both employees and managers commit fraud. In fact, perfectly honest people commit the overwhelming majority of frauds and they do so because they

EXHIBIT 2
THE SLIPPERY SLOPE OF FRAUD

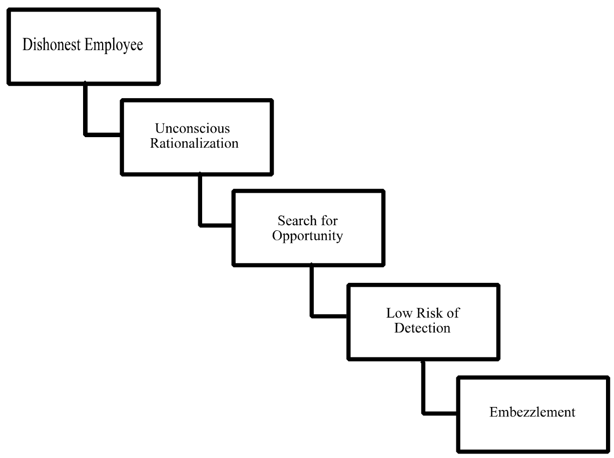


get caught on the slippery slope of fraud and slide into embezzlement.

As Exhibit 2 shows, there are four distinct factors which lead honest people to commit fraud. These include a perceived need for money, the recognition of an opportunity to commit fraud, and a perception that the probability of detection of a fraud is low (Wells, 1997; Stocks, 1997; Cressey, 1973; Albrecht, Howe & Romney, 1984). Finally, the honest person must find a way to rationalize the behavior in order to commit the fraud.

This last separates honest people from dishonest people. Honest people only commit fraud when they can justify the action in their own minds. As Exhibit 3 shows,

EXHIBIT 3
THE THIEF AT WORK



dishonest people begin with an unconscious rationalization of their behavior. Thieves perpetually recognize that their actions are appropriate as they are so self-focused and self-centered that they always feel justified in taking what comes to hand. Fortunately for businesses, there are few dishonest people. Unfortunately, most honest people can find themselves stealing from their employers under the right conditions (Wells, 1997; Albrecht et al., 1984; Cressey, 1973).

An anecdote attributed to Abraham Lincoln, Honest Abe, highlights the problem which we face from honest employees. The story goes like this:

> *Abraham Lincoln once threw a man out of his office who had offered him a substantial bribe. Mr. Lincoln angrily turned down the bribe and explained the source of his anger to an observer: "Every man has his price, and he was getting close to mine"* (Stocks, 1997).

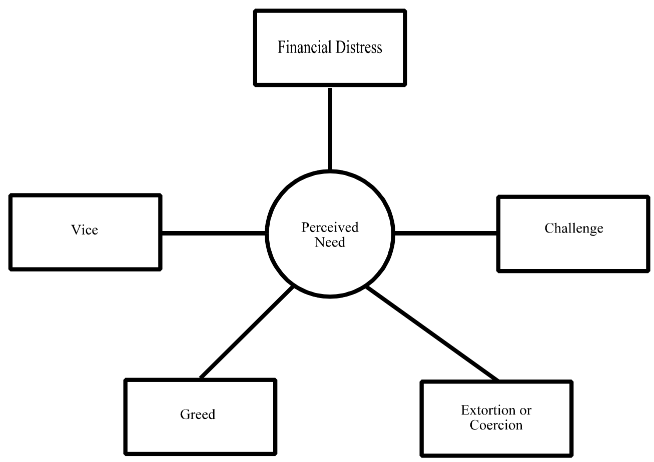
The anecdote illustrates that all of us can be tempted and all of us can fall. Even the most honest among us, when faced with financial crisis which dooms a loved one, may take a loan with every intention of repaying it. Perceived need is a critical aspect for everyone (Wells, 1997; Cressey, 1973).

THE PERCEPTION OF NEED

Exhibit 4 displays the factors which influence the perception of need. As the exhibit shows, the primary aspects include financial distress, vice, greed, extortion, and the challenge of the action. Financial distress is the source of most needs driving honest people to commit fraud. This distress may come from an illness of a family member, the loss of a job within the family, or any of a host of legitimate financial needs (Wells, 1997). The key is that the individual has no legitimate means of satisfying the financial need. That is, the individual can borrow no more, nor find any other source of funds. People experiencing such distress may well be tempted to borrow from their employers without that employers' knowledge (Albrecht et al., 1984).

Financial needs can also be driven by less than legitimate demands. For example, people may fall prey to any of a number of vices which create a need for additional money. These may range from gambling to drugs, but all vices tend to require ever greater funds as time passes (Stocks, 1997).

EXHIBIT 4
FACTORS IN THE PERCEPTION OF NEED



In addition, an honest employee may fall prey to extortion on the part of an outsider or another employee. Blackmail of a trusted employee is a time proven technique among professional criminals and may become more prevalent as more professional white collar criminals arise. However, it is even more likely for an employee, especially a manager, to feel coerced into fraud by unrealistic performance standards, expectations and requirements.

An employee may recognize that the only way to achieve the performance standards required is to *cook the books*. In fact, an employee may feel that his or her position is in jeopardy without taking such an action. In that case, the fraud distorts the financial statements (Wells, 1997). Alternatively, the only way to achieve a bonus or commission which an employee greatly desires or needs, could be to commit fraud (Wells, 1997).

Michael Douglas declared that *"Greed is good!"* in the now classic film *Wall Street* (1987). However, greed in employees, however natural and normal such a trait may be, is a recipe for embezzlement. Sadly, initial *borrowings* predicated on financial distress frequently create greed where it did not exist before. It is almost trite to say that:

> *Embezzlers never stop. They never save their money and they get more greedy over time. It may be extremely hard to cross the line and be dishonest the first time, but once an individual crosses the line, he or she never stops until caught.* (Stocks, 1997)

Of course, one must always guard against stereotypes, but experience does suggest that greed takes over when financial distress or some other factor was the initial motive. That is, greed drives subsequent frauds.

A certain amount of greed is almost always present and is a key factor in driving an individual to commit minor frauds involving expense accounts. This is especially the case when an atmosphere exists in the firm which produces a casual and continuous *fudging* of expense and reimbursement vouchers(Wells, 1997).

Finally, some people, especially those who find themselves using computer systems to steal are unable to resist the personal challenge inherent in the action. These people need the thrill that the action itself creates rather than the money which results. The intellectual challenge may initially be sufficient, but experience teaches that greed becomes a factor upon success and drives a fraudster to subsequent acts (Albrecht et al., 1984; Wells, 1997).

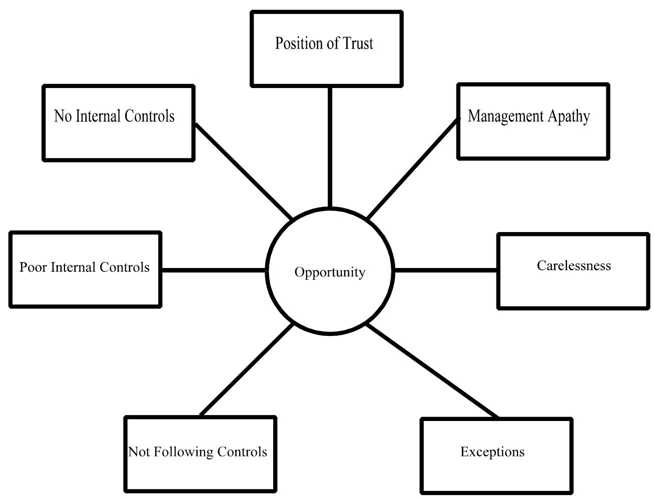
FRAUD OPPORTUNITY

Perceived need alone will not precipitate fraud. There must be an opportunity. Exhibit 5 describes the factors which create opportunities to commit fraud. As the exhibit shows, internal controls, their absence, their weaknesses, or failure to follow them, feature prominently in fraud opportunity (Cressey, 1973; Albrecht et al., 1984).

This is particularly relevant to small businesses because they so frequently have little or no internal controls. The most basic of all internal controls is the separation of duties. By requiring a different person to post the records from the person who opens the mail or makes bank deposits, this control means that collusion between two or more employees is required before a fraud can be committed. In theory, collusion is a much more unlikely occurrence than having a single employee become involved in a fraudulent activity. Small firms, however, seldom have sufficient employees to be able to separate duties. Further, most small business owners seem to feel that because they know their employees very well, those employees are more trustworthy.

As Exhibit 5 shows, the position of trust concept is a major contributor to fraud opportunity. We understand that trust is required in order to conduct business, but to assume that an individual employee is always and perpetually above temptation is naive in the extreme.

EXHIBIT 5
FACTORS IN FRAUD OPPORTUNITIES



Proper restraints should always be in place, if for no other reason than to protect people in positions of trust from suspicion if and when something does happen (Cressey, 1973).

Management apathy toward fraud is rife throughout American businesses and is especially prevalent within small firms. This attitude is partially the result of an unwillingness to confront the issue of fraud; it is not a socially acceptable subject for polite discussion. Perhaps a more insidious factor in the management attitude is the acceptance that a certain amount of minor theft is inevitable. These *wages in kind* are to be expected and most people do take home a few office supplies or some of the items in inventory on occasion. If we make too much of this minor pilferage, we are likely to damage morale and increase demands for higher wages as well as drive up *goldbricking.* Regardless of its cause, managerial apathy ignores the reality of human behavior. Informal social controls are known to be the best deterrents to aberrant behavior (Tyler, 1990; Wells, 1997). The attitudes of one's coworkers is dramatically affected by a general perspective that management simply does not care about performance or behavior.

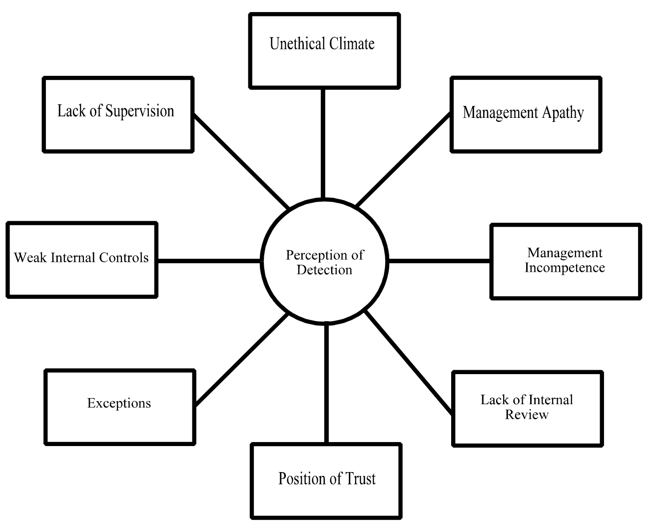
Carelessness is almost always a result of a belief that management simply does not care about one's performance. It is unimportant to carefully process transactions or pay attention to detail and the attitude of the supervisor makes it clear just how unimportant it is. One is not rewarded for such attention or care, and sloppy people make just as much and do just as well. This is a dangerous problem, especially in a small business, because carelessness leaves the door open for people to bypass any control systems which might exist.

Finally, the processing of exceptions can increase the opportunity to commit fraud. Exceptions are unavoidable. No system can be designed to handle every possible situation which can arise. The problem is that exceptions must be handled outside the control system. If these exceptions are not individually reviewed by a responsible party, the opportunity exists for artificial exceptions to be created as openings to fraud (Hollinger & Clark, 1983).

PERCEPTION OF DETECTION

The probability that a fraudulent activity will be detected is less important than an individual's perception of that probability. As is generally the case, what is real is what people believe to be real. Exhibit 6 displays eight primary factors which contribute to a perception of a low probability of detection of any fraudulent activity. These include a lack of supervision, weak internal controls, failure to review exceptions, positions of trust which are above review, a lack of internal review, management apathy or management incompetence, and a general climate in the organi-zation which is unethical (Cressey, 1973; Hollinger & Clark, 1983; Wells, 1997).

EXHIBIT 6
FACTORS IN THE PERCEPTION OF DETECTION



We have previously discussed the issue of internal controls which include adequate supervision, an internal review, and a proper review of exceptions. In addition, we have discussed management apathy and the problems attendant on a position of trust. These factors create opportunities for fraud as well as making it more difficult to detect when it has occurred.

If employees consider the management to be incompetent, they will also assume that those managers are incapable of detecting fraud. This may well be an accurate perception, although the original perception of incompetence may not be accurate.

An entirely new concept we are introducing here is the idea that an unethical climate within a firm contributes to a perception of a low probability of detection of any fraudulent activity. This climate results when owners, managers and other employees are involved in unethical, or fraudulent behavior. The idea is that if everyone else is stealing, detecting those activities is unlikely.

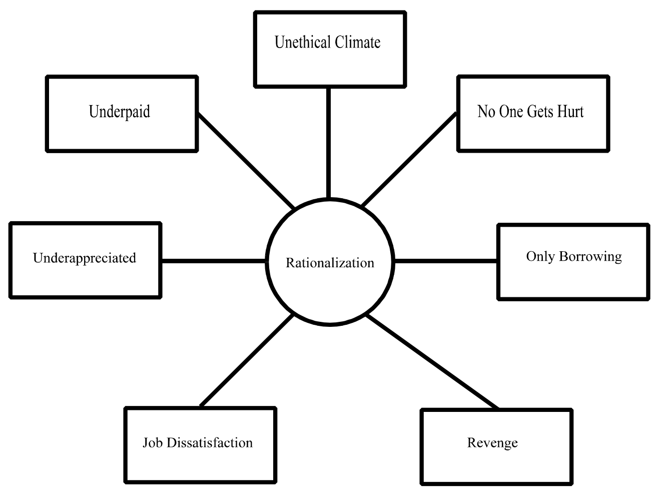
This is especially a problem for small firms because their owners so frequently attempt to avoid income taxes through actions which employees view as fraudulent. In a recent case we observed the dramatic impact which such actions can precipitate. Our client was the owner of a fairly successful automotive repair facility. The business had grown to 15 employees and our client was charging a number of personal expenses against the business to reduce its tax liabilities. These included a beach house, a cabin on the lake, lease payments on three cars, loads of personal insurance, high travel and entertainment expenses, etc. In addition, there may well have been actual cash receipts which disappeared before they could be recorded. Clearly, scrap and other items of value continually disappeared from the shop. The result was a firm which constantly teetered on the edge of financial ruin as it never had significant profits and never had sufficient cash resources to handle its obligations.

Like many, if not most, small businesses, our client had one employee who handled the bookkeeping: all of the bookkeeping. That person, perhaps influenced by his daily observation of the owner's behavior, succumbed to the temptation and dipped into the till. No one discovered his theft until the bank holding the primary business loan became enraged at yet another payment which *bounced,* and called the loan. The bookkeeper confessed, but it was too late. The bank's action forced the closing of the business. We have witnessed similar scenarios with other clients over the years, but the story illustrates how dangerous it can be for a small business to permit an unethical atmosphere to develop within the business. For a small firm, eliminating opportunity may be impossible, so maintaining a high moral climate is crucial to preventing fraud.

RATIONALIZATION

As mentioned earlier, an honest employee must be able to rationalize a fraudulent action in order to commit it. This is the primary difference between a thief and an honest individual (Cressey, 1973; Wells, 1997). This rationalization allows the fraudster to believe that his or her actions are not criminal. As Exhibit 7 displays, there are seven major factors which contribute to an individual's ability to rationalize a fraudulent act. These include the idea that the fraud is only a loan. In fact, many fraudsters, if not most, initially do believe that their actions are in the form of an unapproved loan. As discussed in a preceding section, greed may well become a later factor and drive subsequent frauds, but the initial act was rationalized as a loan badly needed in a financial crisis (Cressey, 1973; Albrecht et al., 1984).

EXHIBIT 7
FACTORS IN RATIONALIZATION



Concomitant with that attitude is the notion that no one is hurt by the fraud. The company can clearly handle the loss. Alternatively, an individual may actually wish to harm the company out of revenge for a supervisor's actions, the loss of a promotion, a demotion, or any action or lack of action which the employee deems to be personally unfair or professionally damaging (Wells, 1997).

By far, the most prevalent sources of rationalization revolve around an employee's belief that he or she is underappreciated or underpaid (Wells, 1997). This makes the commission of a fraud a simple correction of an unfair situation or the rendering of one's proper dues.

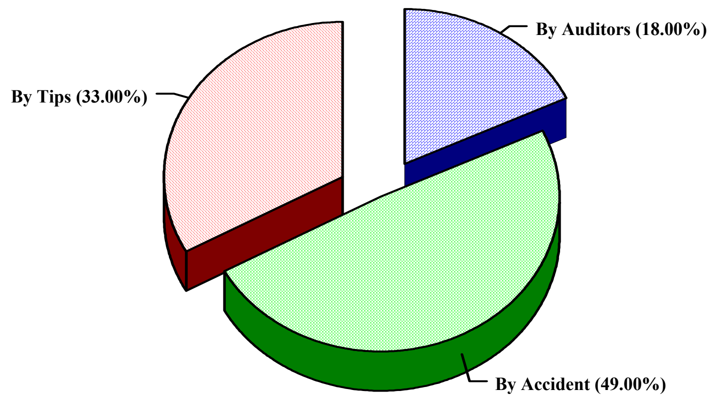
A great deal of research has shown that job dissatisfaction is frequently associated with an employee fraud (Hollinger & Clark, 1983; Wells, 1997). Unhappy workers have low morale, and are more likely to exhibit a host of problems from excessive sick days, to employee theft.

Finally, we note that an unethical climate can be a clear source of rationalization. As discussed in the preceding section, this is particularly a problem for small businesses. The idea is quite simple. When an employee sees that others, especially managers and owners, are involved in fraudulent activities, there is little reason to refrain from such actions.

FRAUD DETECTION

Fraud is not generally detected by auditors. In fact, most fraud is detected by accident or through tips from other employees (Stocks, 1997). As Exhibit 8 shows, only about 18% of frauds are detected by auditors, a third by tips and 49% are detected accidentally (Stocks, 1997). To this dismal picture we must add the fact that the overwhelming majority of frauds are never detected. Of course, the primary reasons for the low level of detection are the same reasons that so many frauds occur in the first place: the factors which create opportunity and contribute to a low level of perception of detection prevent the actual detection of frauds. Consequently, the best approach to increasing the rate of actual detection is to eliminate or mitigate the factors in opportunity and detection perception.

Exhibit 8
Sources of Fraud Detection



There is another factor which the data reveals; one which is vitally important to building a program to combat fraud. As the graph discloses, fully one third of frauds are detected by tips. It is well established that the vast majority of employees are disturbed by fraudulent activities which they recognize within their firms, however, they are reluctant to report such activities for fear of becoming involved in an embarrassing, messy situation, fear of retaliation, fear of not being believed, etc. (Wells, 1997).

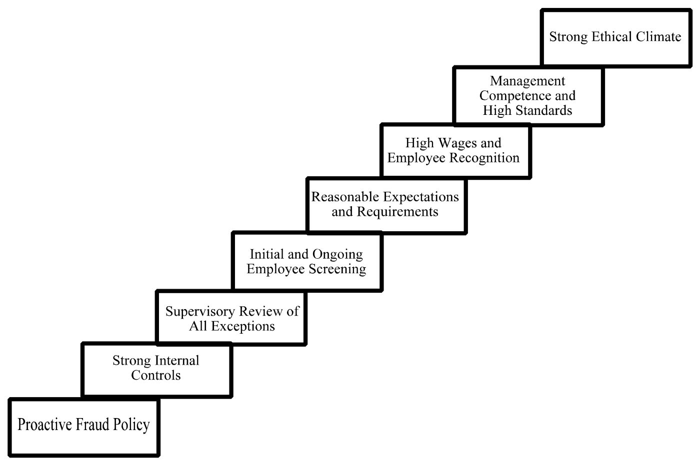
At the same time, experience teaches us that when an employee engages in fraud, other employees in the firm know about it. In a recent case, we were engaged to work with a firm which had just discovered a fraud and was attempting to prevent future occurrences. The firm was quite small with just eight employees, but we had been in the business less than 30 minutes when the first employee whispered to us how upset she had been to witness the fraud and how pleased she was that we would be working to prevent such problems in the future. Within two hours, five of the eight employees had confided to us that they knew about the fraud when it was occurring, but had been reluctant to say anything to the owner. Time and again, this situation is reported by fraud investigators. When an employee engages in fraud, other employees know about it.

The issue is how can we overcome their reluctance to report the fraud? We will deal with that question and other factors relating to the prevention and detection of fraud, especially in small firms, in the following section.

CREATING AN ETHICAL CLIMATE

The title of this section reveals the time proven approach to preventing and detecting fraud: we must create an ethical climate within the firm. Nothing functions as well in deterring fraud as a real environment of honesty and ethics within the firm: not internal controls, not outside auditors, nothing. This is extremely good news for small businesses. Even a firm which cannot afford to implement sound internal controls can still protect itself against fraud. It need only create the proper climate (Wells, 1997). Exhibit 9 describes the steps involved in creating such a climate.

EXHIBIT 9
STEPS IN CREATING AN ETHICAL CLIMATE



First, and foremost in the process is the establishment of a proactive fraud policy. This means that we must bring fraud out of the closet, recognize that it occurs in virtually every organization in varying degrees, make all managers and employees aware of the serious dangers which fraud creates and take proactive steps to stop the problem. The first such step must be for the owners and managers to recognize that leading by example is required to garner employee belief. People at the top in the business must embrace high ethical standards and display them to everyone in the organization. To this end, a code of ethics for the firm is a great idea, but the most important point to remember is that *nothing* goes on in a business, especially a small business, without others in the firm knowing about it. That means that a deviation from a code of ethics, either written or implied, on the part of the owner, the chief executive, senior management, etc., will destroy the ethical climate. The owner or chief executive must be serious about ethics, and must take immediate and serious action against any managers behaving in an unethical fashion (Wells, 1997).

The ethics to which we refer in the preceding paragraph obviously include fraud, but they are more far reaching. To establish a code of high moral conduct, the business must be operated in an ethical fashion; it cannot take advantage of suppliers, customers, employees, or others; it cannot pretend to be ethical; it must be ethical. The reasons have to do with the real deterrent for any deviant activity: fear of the loss of respect of one's peers. Informal sanctions occur when an individual breaches the real code of behavior in any social organization. For honest people, these informal sanctions are more effective than any punishment or formal sanctions (Wells, 1997). Noting that most fraudsters are honest, creating an environment in which informal, social sanctions, and the loss of peer respect will accompany any fraudulent activity is the single best deterrent any organization can envision.

This higher stance is the first, and most important aspect of a proactive fraud policy and is especially important for small firms who have limited resources which will make the subsequent step described in Exhibit 9 more difficult. Creating, maintaining and enforcing strong internal controls is an attainable objective in larger firms (Hollinger & Clark, 1983), but we must recognize that such controls do slow down the process of business and management and do create costs in the form of additional personnel and time. Many small firms, especially start up firms or very small businesses, simply cannot afford strong internal controls. For these businesses, it becomes especially important for the owner to take an extremely high ethical stance and to pay close attention to the remaining steps in creating the proper climate.

Exceptions can never be eliminated, even in the most bureaucratic organization (Hollinger & Clark, 1983). It is impossible to create a system which anticipates every transaction or operation. In small firms, exceptions may even be the rule. The key in creating the proper climate within the firm is to ensure that everyone recognizes that exceptions must be approved: every exception should be reviewed and approved by the supervisor of the individual handling the exception. In small businesses, this may mean the owner approving most exceptions (Wells, 1997). Only by creating a situation in which exceptions cannot disappear, can a firm ensure that they do not mask a fraudulent action.

Initial employee screening is really vital in ensuring that we do hire honest people. As described in a previous section, dishonest employees do exist and they are constantly seeking an opportunity in which to commit fraud. Some fraud experts believe that a general decline in the moral fabric of the society is contributing to the occurrence of an increasing number of dishonest people (Wells, 1997). Whether that is true or not, employee screening is vital to making the work force honest and ethical.

Unfortunately, this process is extremely difficult, especially for small businesses because one cannot depend upon calling references to identify a potential thief. In the first place, a former employer can never disclose any suspicion of fraud, only that a fraud was prosecuted against an individual. Since such prosecutions seldom occur, calling references is unlikely to reveal anything of value in the hiring decision. That is not to say that it should not be done. In fact, every former employer and school should be contacted to confirm that the prospective employee was truthful in providing historic information. Be sure to look up telephone numbers rather than rely on those provided by the applicant. Even a very small business can accomplish this level of check as it simply requires a telephone and a few minutes of time.

To assist in screening applicants, a credit check is valuable. You must obtain permission from the applicant to conduct such a check, but it can reveal a great deal of information and provide insight into the financial affairs of the prospective employee. This is a simple process which a small business can easily accomplish by making arrangements with the local merchant's association or registering with any of several national credit organizations. It is so important that we recommend its use in ongoing employee screening. That is, check the credit of every employee once each year. This will help point out changes in the financial condition which could lead an honest person to becoming hostage to a perceived need.

The best screening techniques are actually interview techniques. People trained in interviewing can identify inconsistencies and pinpoint lies with an extremely high degree of success (Wells, 1997). Unfortunately, this requires training. Larger firms can and should arrange for training in interview techniques for people who will be involved in screening applicants and employees. A small firm may wish to consider engaging a professional from outside the firm to handle its interviews. This may be a private investigation firm specializing in white collar crime, or an accounting firm specializing in fraud investigations. It must be an organization with people trained in interview techniques.

These interview techniques should also be applied as part of the ongoing screening. Some firms employ lie detectors for this process, but that is also an expensive process and can easily create ill will and low morale within the organization if not handled professionally. An annual interview combined with each person's annual evaluation can help to identify employee problems before they reach the fraud stage. This leads well into the next step in creating an ethical climate: reasonable expectations and requirements. During this annual review and interview, one should address the individual's performance with respect to the job requirements and set expectations for the future. These expectations must be reasonable. They do not have to be easily accomplished, but they must be deemed reasonable by the managers and employees in general or they will erode the climate which we are trying to create. The key is to create an environment which employees and managers consider fair.

A major aspect of fair treatment is clearly wages. We need to pay wages which are considered by the managers and staff as high in comparison to the market and area. Small businesses may particularly feel that this is an imposition, but one must remember that employees are critical to the successful operation of any business. To be most successful, a business needs the best people it can recruit and retain. High wages are the best approach here, and they also contribute to an attitude of fairness and equity within the company. Along those same lines, employees need to be recognized for their performance, both financially and otherwise. Good performance should be valued in the firm and that value should be tangible and apparent to the employees.

Finally, the company should recognize that managers must be held to higher standards than employees. Managers are role models and have a disproportionate influence on employee attitude, morale, and behavior because of their positions within the firm. Consequently, managers must be held to high ethical standards. Above all, managers must be competent; competent to perform their duties; competent to supervise employees; competent to review and evaluate exceptions; competent to recognize problems within the ranks; competent to root out fraud. If we have competent managers, that is the last, but most critical step, in creating an ethical climate within the firm.

CONCLUSION

In conclusion, the authors believe that the available evidence supports a conclusion that the majority of small business failures are caused by fraud. This is good news, because fraud can be limited, if not eliminated, even in very small firms with limited financial resources. First, one must recognize that most fraud is committed by honest employees who have a perceived need for money, recognize an opportunity to take that money, perceive the probability of detection as low, and have the ability to rationalize their behavior. The best defense against fraud is a high ethical climate within the firm. This is not just a matter of internal controls. In fact, internal controls are the most costly and the least effective aspects of limiting fraud. The most important aspects have to do with owners and managers setting an example of ethical behavior and requiring employees to adhere to those standards. The real deterrence to unethical and fraudulent behavior is the fear of informal, social sanctions: i.e., the loss of respect of peers. This loss of respect results from violation of broadly held beliefs and mores. Consequently, to bring informal sanctions into play, we must create an atmosphere within the company in which all the employees and managers adopt the appropriate mores: *unethical actions and fraud are intolerable*. There is no stronger weapon against fraud.

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