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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, summer, and 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 8 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 both organizations. 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

THE ABCS OF EMPLOYEE HANDBOOKS FOR ENTREPRENEURS

I.M. Jawahar, Illinois State University
Stacy Gavin, Illinois State University

ABSTRACT

Every organization must have an employee handbook. Depending on the contents, an employee handbook could protect the organization or could become a damaging liability. The primary purpose of this article is to inform entrepreneurs about the significance of employee handbooks. To accomplish this purpose, we discuss a number of key elements including the benefits of handbooks, contents of a typical handbook, the effective use of clauses and disclaimers, concerns with on-line handbooks, and issues that pertain to revisions or additions to handbooks. Knowledge of these key elements and the practical advice we offer will help entrepreneurs develop employee handbooks that contain legally defensible and effective mechanisms for managing employees as well as for protecting their organizations against legal challenges.

INTRODUCTION

Managing human resources is just as important to a small business as it is to a large organization. The threat of allegations of discrimination poses a significant challenge particularly for smaller organizations that do not have the resources to employ specialists, such as human resources or risk management professionals. Instead, the small business owner or entrepreneur has to deal with human resource-related activities, in addition to managing business-related activities. For instance, a small business owner must engage in several human resources activities, such as hiring employees, administering compensation and benefits, promoting employees, resolving conflict among co-workers, disciplining employees, and terminating employees.

Mistakes made in performing any of these activities will expose the small business to potential lawsuits. For instance, disciplining employees in an inappropriate manner or terminating employees in an insensitive manner could result in a discrimination lawsuit or charges of wrongful termination against the small business owner. These types of lawsuits could ruin a small business. For instance, the median compensatory award for a wrongful termination case is more than $200,000. And, since 1992, the number of civil rights employment cases filed in federal courts has more than doubled (Levin, 1998). According to the Equal Employment Opportunity Commission, in 2001 alone, businesses paid over 725 million dollars to plaintiffs who were successful in alleging discrimination.

Given the substantial awards and the litigious business environment, small and big businesses should do everything possible to avoid lawsuits. Avoiding lawsuits is particularly critical for small businesses because a single lawsuit could easily bankrupt a small business. In this regard, employee handbooks are invaluable to small businesses. Employee handbooks not only serve as a deterrent to lawsuits but a well-designed employee handbook could be used to successfully defend a lawsuit.

This article is organized into six sections. In the first section, the benefits of employee handbooks to small businesses are described. In the second section, the contents of a typical employee handbook are noted. Third, the different types of clauses are described and their effective application is discussed. Fourth, suggestions for the effective use of disclaimers in handbooks are provided. Fifth, issues relevant to on-line handbooks are discussed. Finally, the major issues to consider when revising and/or updating employee handbooks are discussed.

BENEFITS OF EMPLOYEE HANDBOOKS

Employee handbooks are invaluable to small businesses. Unfortunately, many small business owners/entrepreneurs do not believe that employee handbooks are valuable, or even necessary. We conducted informal telephone interviews with 30 entrepreneurs. The size of their organization varied from 7 employees to 61 employees. Eighteen entrepreneurs (60%) indicated that they did not have an employee handbook in their organizations. To our surprise, sixteen entrepreneurs (53%) indicated that they do not see the need for a handbook. Eight entrepreneurs mentioned that they would like to have a handbook but noted that they have not had time to create one yet. If our sample were to be representative of the "small business owner/entrepreneur" population, then the results are very troubling. They are troubling because results indicate that most small businesses do not have a handbook, and worse yet, about 53% of small business owners/entrepreneurs do not see a need for, or benefit of an employee handbook.

It is apparent that small business owners/entrepreneurs do not realize that a well-designed employee handbook can help accomplish several objectives and goals that are crucial for any small business to succeed. These goals and how employee handbooks help accomplish those goals are briefly discussed next.

Share Core Values

It is important to all organizations, large and small, to share their core values with employees. An employee handbook is an important vehicle for small business owners to share their core values, philosophy, and organization's mission with employees.

Improve Morale

Employee handbooks that clearly communicate expectations, and convey that policies and procedures will be applied consistently are likely to improve employee morale. In many small businesses, a few employees are likely to develop close ties with the small business owner or entrepreneur giving other employees the perception that their employer favors some employees over others. Handbooks that indicate that all employees will be treated consistently will allay the fears of employees who are not in the "inner circle" of the entrepreneur. Of course, actions of entrepreneurs should be consistent with stated policies and procedures. When employees believe that they will be treated in a fair and consistent manner, employee morale is likely to be very high. When morale is high, employees are likely to act in ways that would benefit the company, which is exactly what small business owners and entrepreneurs desire from every employee.

Free up Business Owner's Time

Most, if not all small business owners and entrepreneurs work very long hours. Time, therefore, is a precious commodity. Most entrepreneurs cannot work any harder but they can work smarter. They need to find ways to free up time to focus on key business activities and engage in planning to ensure continued success of the organization. Thus, they should look for ways to reduce time spent on activities that do not directly contribute to the growth of business. An employee handbook can help in this regard. When policies, procedures, and expectations are in writing, employees can look up the number of sick days, or vacation days and other such benefits available to them in the employee handbook. Business owners can then spend more time focusing on business issues rather than having to respond to questions, answers to which can be easily found in the employee handbook.

Avoid Lawsuits

Lawsuits are a nightmare for every organization, particularly for a small business. A lawsuit can quickly drain the resources of a small business. In addition to financial resources, lawsuits will force the entrepreneur to direct attention away from managing the business to fighting the lawsuit. Obviously, every entrepreneur would like to avoid lawsuits. Can a handbook help in this regard? The answer is a resounding yes! Research shows that handbooks reduce the risk of being sued by an employee. An attorney of a disgruntled employee will request the employee handbook during discovery phase of building a case against the employer (Milligan, 1999). The attorney will be reluctant to file a lawsuit if rules, policies and procedures are clearly articulated in the organization's employee handbook (Farr, 1999).

Defend Against Lawsuits

Obviously a goal of a small business should be to avoid any lawsuits. But, if an employee files a lawsuit, can a handbook help? Again, the answer is yes. Consider this: if an employee who was fired for violating company policy alleges discrimination, the burden of proof shifts to the employer, and the employer has to show that the employee was terminated for a legitimate business/job-related reason (Gatewood & Feild, 2001). Employee handbooks that clearly state the policies and procedures are the best place to start for building a successful defense against such legal challenges (Milligan, 1999). Thus, an employee handbook becomes an important document that could be effectively used by a small business owner to defend against many types of discrimination charges. Small businesses that do not have a handbook with written policies and procedures will most likely not be able to put forth a strong defense. The fact that a single lawsuit could severely debilitate a small business underscores the importance of a well-designed employee handbook.

Obtain Insurance

Because of the pervasive threat of lawsuits, it makes good business sense for small businesses to purchase employment practices liability insurance (EPLI) and limit liability. According to Noreen Graham, Assistant Vice President for Becher & Carlson Risk Management Inc., most insurers are unlikely to even give a price quote for such coverage to businesses that do not have an employee handbook. In fact, EPLI applications of all insurers who offer such coverage request details about, and a copy of, the employee handbook (Howard & Jawahar, 2002). In addition, one of the factors influencing the premium for such coverage is the quality of the contents of the employee handbook (Howard & Jawahar, 2002; Levin, 1998).

CONTENTS OF A TYPICAL EMPLOYEE HANDBOOK

In the previous section, we discussed the significance of employee handbooks to small businesses. Every small business must have an employee handbook. Typically, handbooks contain three broad sections: Information about the company, policies and procedures, and employee benefits. Contents of each section are described next. Small business owners should consider including information about their company, policies and procedures, and employee benefits in their handbooks but must customize the information to fit the needs of their organizations.

Company Information

Information about the company is usually included at the beginning of the employee handbook. Typically, a welcome letter from the owner/entrepreneur should be included. The letter is usually followed by a brief description of the history of the company. Next, a discussion of the company's mission, goals, and expectations should be included.

The company information section should be attractive and should be written to create a positive impression about the company. It should contain sufficient information to socialize a new employee to the company and its environment. Like other sections, this section should be updated as necessary.

Policies and Procedures

Policies outline the rules and expectations of the company. Many states legally require companies to include drug/alcohol, harassment, and equal employment opportunity policies in their handbooks. Some states also require nondiscrimination policies. It is important that small business owners include what is legally required as a starting point. Otherwise there is an opening for any employee, union representative, or even government regulator to press charges against the company. Small businesses could also include policies that address smoking, prohibited conduct, right to intellectual material, right to privacy, arbitration, solicitation, and dress code in the employee handbook.

Procedures outline steps or actions that could be taken if any of the policies or rules is not followed. Procedures could deal with a number of issues including safety, employee discipline, harassment, and discrimination. For instance, procedures could delineate the steps to follow if harassment or discrimination is alleged, describe the process to file a grievance, or describe actions to be taken in case of emergencies.

Mistakes to Avoid When Writing Policies and Procedures

It is important for small business owners/entrepreneurs to avoid including unrealistic or insincere policies. According to Dean Reynolds, Director of Risk Management and Human Resources at Nissan North America Inc., "failure to follow your own policy can be worse than not having a policy" (Milligan, 1999). If a small business owner does not follow a policy as stated in the employee handbook, it will not only discredit the business to employees but will also open the business to lawsuits. In addition, if owner/company suddenly decides to enforce a policy contained in the handbook, employees may have good grounds to sue the company because they had no reason to believe any of the policies would actually be enforced.

In the employee handbook, small business owners/entrepreneurs must include a clear and specific procedure that will be followed in cases of harassment. Why? The reason is simple. Courts including the United States Supreme Court have consistently favored companies in cases where a strong policy is in place and strictly followed (London, 1999). The policy should include a broad definition of harassment, lines of authority where complaints may be taken, and a clear indication of what will follow after a complaint has been lodged. Consistently following through with every complaint is the most important defense with a harassment policy. Just saying it exists is not enough; it must be followed precisely. In a national survey conducted in 1997, the median award in harassment and discrimination cases had risen nearly 300 percent to $250,000 (McAndrew, 1999). By having a good non-harassment policy, educating employees about the policy, treating each complaint seriously and taking appropriate action, small business can substantially limit liability.

Policies and procedures are critical for directing behavior of employees toward organizational goals. Companies, both big and small, rely heavily on policies and procedures to manage employees. In addition, most lawsuits either allege that the company violated its own policies or procedures or challenge the legality of the company's policies and procedures. Therefore, small business owners/entrepreneurs should consult an attorney, preferably one who has experience in either corporate law or in human resource management and compliance, review policies and procedures before publishing them in the handbook.

Benefits

Some benefits, such as social security, unemployment insurance, and workers compensation, are legally required and must be included in employee handbooks. Other benefits, such as life insurance, health insurance, time off from work, and designated parking spaces may be offered to all employees, or they may be available only to select workers. Each benefit offered should be described to highlight the advantages for the employees. Employers who contribute toward retirement benefits should also include the proportion of the contribution made to the retirement accounts of employees. In general, a benefit will have more value to employees if they are able to see how much the employer actually spends to provide that benefit. An awareness of how expensive benefits are to employers is likely to build commitment and loyalty. Commitment and loyalty of employees are key ingredients for the success of any small business.

Mistakes to Avoid When Describing Benefits

Although employers should communicate the costs of providing benefits to employees, we advice small business owners and entrepreneurs to not include specific numbers or amounts in the employee handbook. Each employee's cost and benefit amount, especially for different types of insurance, will vary. This is especially true when employees are allowed to choose among different options or coverage, and when they are able to enroll their families. Only state that the benefit may be available and who to contact with questions about cost or coverage.

Some benefits, such as social security, unemployment insurance, and workers compensation apply to all employees but other benefits, such as unpaid leave under Family Medical Leave Act (FMLA) do not. For instance, FMLA allows an employee up to 12 weeks of unpaid leave for the birth of a child, adoption of a child, or to care for a family member who is ill. However, only employers who have 50 or more employees employed within a 75-mile radius are required to comply with FMLA. So, if at one location (e.g., branch office), there are fewer than 50 employees, the company is not legally required to offer FMLA benefits to employees at that location. However, if the same employee handbook is given to employees at all locations and it lists FMLA as a benefit, then even if there are fewer than 50 people employed at a particular location, the company will have to provide FMLA benefits to employees at that location (Flynn, 2000).

In a recent case (Thomas v. Pearle Vision, Inc., 2001), the 7th Circuit court of Appeals ruled Pearle Vision to provide FMLA benefits to the plaintiff even though the plaintiff was employed at a location where Pearle Vision had fewer than 50 employees. Pearle Vision had listed FMLA as a benefit in their employee handbook but had not specified the criteria for eligibility. Therefore, it is very important for small businesses to clearly state in the handbook to whom each benefit applies and what criteria will be used to determine eligibility.

EFFECTIVE USE OF CLAUSES IN HANDBOOKS

Clauses are statements in the employee handbook or contract that either allow or prohibit specific behaviors. Small business owners should seriously consider the use of clauses in their company handbook. Some of the most important clauses include the at-will employment clause, non-compete clause, confidentiality clause, no-solicitation clause, and arbitration clause. If used effectively, these clauses will protect the interests of the small business owner/entrepreneur. In some states, an agreement must be signed to document that the employee has read and understood the clause. Effective use of the aforementioned clauses is described next.

At-will Employment Clause

At-will employment is an employment relationship that allows either the employer or an employee to discontinue the employment relationship at any time, with or without reason. In this relationship, no contract exists. At-will clauses must be included in the employee handbook.

In small businesses, many employees are likely to develop close ties with the owner/entrepreneur and come to take the employment relationship for granted. During tough times, if they are asked to leave the organization, they could protest or threaten a lawsuit alleging violation of an "implied" employment relationship. Therefore, including the at-will employment clause in the handbook will be a tremendous asset for a small business owner/entrepreneur.

How to Phrase an At-Will Clause

The most effective way to phrase an at-will clause is to simply state "this employment relationship is at-will." The straightforward wording will clearly convey a desire for an at-will relationship, but it will still need to be backed up by the rest of the handbook and the actions of the small business owner. Simple and straightforward wording of the at-will employment clause will minimize confusion and help avoid complications in the future. For example, some employers add that nothing verbal will alter the at-will employment relationship in any way. However, such additions enable employers to imply contracts they do not intend to complete. Because adding statements such as, "nothing verbal will alter the at-will employment relationship in any way," could be misinterpreted, such additions are unlikely to protect the employer. On the other hand, it may harm the employer by creating a warning flag to courts that the employer may have had the intention to use it to mislead employees. This is particularly applicable to small businesses because of the close ties employees have with owners and the prevalence of family atmosphere in small businesses. So, do not include such additions or modifications.

Instead, to reinforce the at-will employment relationship, owners and entrepreneurs should add the following statements to the statement that "this employment relationship is at-will."

Nothing in this employee handbook represents a guarantee of employment for any length of time.

The employer reserves the right to change, add, or delete information included in the employee handbook, and those changes will apply to all current and future employees.

All changes will be in writing.

To make the handbook more consistent with an employment at-will clause, do not refer to full-time employees as "permanent employees" because it could be assumed that all full-time employees are permanent and, therefore, are not employed under the at-will clause. Such misuse has been known to smudge the intent of at-will employment. In contradictory cases where interpretation of the handbook conflicts with interpretation of the at-will clause, the courts will decide if the employee was hired at-will or not, and the courts are not known to be business-friendly. So do not include fuzzy language that could void the at-will clause.

The at-will clause should be included in the handbook. Employees should be asked to sign and date a form to acknowledge the at-will employment relationship. This form should become a part of the employee's personnel record. Traditionally, employers have asked that new employees sign an agreement that states they have received the manual and accept the terms within it. The signed at-will acceptance form does not replace this form. Both forms must be signed and dated and placed into the employee's file.

According to Levin (1998), in 1996, cases of wrongful termination brought a median award of $200,000 per person. The $200,000 award amount does not include the cost of rehiring and retraining the person(s) or the costs of the time and effort involved in litigation. Thus, having a clearly written at-will clause that makes employees aware that their employment is strictly at-will can save the small business owner hundreds of thousands of dollars, even if it only discourages one case from going to court.

Non-compete Clause

The purpose of the non-compete clause is to keep employees from competing directly with the company by starting their own business or working for a direct competitor, for a specific duration. The non-compete clause is usually included in an employee contract, but if it is relevant to all employees and/or there is no written contract, it could be included in the handbook. The clause acknowledges that the employee may leave the company at some point in time and prohibits the employee from going to work for the company's competition. Whenever possible, the specific companies that the employee cannot work for after leaving an employer should be identified. The intent of the non-compete clause is to prevent an employee from learning trade secrets, then selling them to the competition or using them to secure a better job with the competition. In addition, it prevents the employee from taking the knowledge and using it to create a new business that directly competes with the former employer.

When using a non-compete clause, state exactly who it includes and for what period of time. According to Retkwa (2001), these clauses are not favored in courts, and anything deemed unreasonable tends to be discarded. In 2001, PaineWebber lost two cases against employees who violated PaineWebber's non-compete clause. The court ruled the clause to be "void and unenforceable" because it required the employees not to work in an entire industry for one year after leaving PaineWebber. It is always better to identify companies for whom the employees should not work than to state that employees should not work for any company in an industry. If an employee is knowledgeable about just one industry, the clause will drastically impair his/her ability to find work, creating a significant disadvantage for the employee and his/her family. If this happens, like in the PaineWebber case, the clause will likely be thrown out. Because PaineWebber's non-complete clause was very restrictive (and void), the court also ruled that PaineWebber would not be allowed to collect back pay from the plaintiffs, which added up to over $800,000 for only one of the plaintiffs. Thus, a poorly written clause will not only be ineffective at protecting the company but will actually protect the employees.

A well-written clause will specify: (1) the companies for which employees should not work, (2) the geographical areas in which employees should not compete with the company, and (3) the time period for which an employee is not allowed to compete directly with the company for business. As a general rule, a non-compete clause should not prevent competition for extended periods of time. A reasonable time period will vary depending on the business and the nature and depth of the competition being included, but six months to one year is typical. If many companies are included as competitors to avoid, then the time period must be relatively short to compensate for the employee giving up more employment opportunities. On the other hand, if the non-compete clause only lists the two top-most competitors in an industry with many companies, the time period may be longer because the employee will still be able to find a suitable job in the industry.

Why is the non-compete clause important for a small business? Consider the following scenario. You are an entrepreneur operating a specialty store in a small town. You have a half-a-dozen employees who have been with you for many years. One of them is very familiar with your business: knows the vendors, suppliers, your cost structure, and profit margin. Would you like for this person to quit your company and start his/her own company across the street? A non-compete clause that specifies the geographical area within which the former employee cannot compete with the company could prevent this from happening. If this were a larger town with another competitor, you could specify that a former employee cannot work for the competitor upon leaving the organization for a specified period of time. Thus, the non-compete clause, when effectively incorporated in an employee handbook, will provide peace of mind for the small business owner.

Confidentiality Clause

A confidentiality clause specifies the topics an employee may discuss with certain people or, conversely, topics that should not be discussed. In jobs that involve knowledge of trade secrets and recent developments, confidentiality clauses can be used to prevent word from leaking out of the department or, worse yet, the company. It is best to let employees know that there will be negative consequences if they ask for or attempt to share confidential information.

When including confidentiality clauses, be specific about the types of information that can or cannot be discussed. If a clause could be interpreted as prohibiting the freedom of employees to talk about wages, benefits or work conditions, it is unconstitutional and, therefore, invalid. For instance, Sodexho Marriott Services' handbook implied that no confidential information could be discussed among workers. The Hotel Employees and Restaurant Employees International Union was upset because the clause did not specify what the company considered "confidential." The union was concerned that some employees could interpret the clause to mean that they could not discuss wages, benefits or working conditions. In response to the union's concern, Sodexho chose to modify the clause rather than risk their day in court. They chose to include exceptions that were not prohibited (King, 2000). Alternatively, a company could list subjects that are confidential and prohibit employees from discussing those subjects.

The confidentiality clause is particularly relevant to small businesses involved in research and development activities, such as developing new software, biotechnology, or prototypes for clients. If a key employee shares confidential information with competitors, the results can be devastating for a small business. Thus, if the nature of the business activity involves research and development activities, small business owners should seriously consider incorporating a confidentiality clause in the employee handbook.

No-solicitation Clause

A solicitation (or no-solicitation) clause defines who can and cannot solicit coworkers to support a cause, buy something, or join an organization. Generally this clause is only included when solicitation is prohibited. Legally, the clause must be all or nothing because solicitation is a method of free speech. Companies have the right to prohibit solicitation because they are paying their employees to work, not socialize or solicit their coworkers' support for a cause. On the other hand, if solicitation is prohibited, it includes selling Girls Scout cookies or collecting donations for the Red Cross. These causes are dear to the hearts of employees, and the company's support for these types of causes can help enhance employees' satisfaction with the company. Employers, who are forced to take action against employees for doing a good deed or helping a good cause, will obviously look bad.

The reason why employers use a no-solicitation clause in spite of the negative consequences is to prevent union representatives or company employees from handing out or collecting petitions to organize a union in the workplace. While the employer can express antiunion sentiments and give support for those feelings, they cannot exclusively prevent the solicitation of unions. All solicitation must be prohibited.

Therefore, only include a no-solicitation clause if you intend to eliminate all forms of solicitation. Entrepreneurs who operate businesses that are engaged in manufacturing products, fabrication, or otherwise employ individuals in "trade" jobs (e.g., carpenter, plumber, electrician) should seriously consider incorporating a no-solicitation clause in their handbooks for two reasons. First, these jobs/industries are heavily unionized, thus increasing the chance of unionization at the small business. Second, wages of unionized employees are at least 15 to 30% higher than wages of non-union employees. The increase in labor costs will significantly reduce the profit margin, and, if the small business tries to pass on the increased cost to the customer, it will place the small business at a competitive disadvantage. For these reasons, entrepreneurs should use the no-solicitation clause if there is a chance that employees might unionize.

Arbitration Clause

The purpose of the arbitration clause is to clearly communicate that any disagreements between employees and the management of the organization will be subject to arbitration by an in-house or a third-party arbitrator. The employer should obtain a signed acceptance of this clause upon hiring a new employee. Courtroom litigation costs are exorbitant. In contrast, arbitration costs are relatively modest. Companies that use arbitration could save a significant amount of money relative to companies that settle disputes in a court of law. If arbitration is used, companies are able to pay more in whatever settlement is reached and still realize cost savings. Realizing the potential to limit costs, companies even offer incentives to employees who agree to settle disputes through arbitration. It is not uncommon for companies to add a set amount, for example 10%, to the settlement if the employee agrees to use the arbitrator. Use of both in-house and outside arbitrators have advantages, so companies must research to find the best solution for them. Then they need to implement it and make it known that arbitration is their chosen method for finding common ground and resolving problems.

The arbitration clause should be displayed conspicuously in the handbook. In other words, bring special attention to the arbitration clause. That special attention can be achieved by having a signed form to indicate acceptance of the arbitration agreement (Perkins & Terman, 1999). Given the exorbitant costs associated with litigation (entrepreneur's time and money), we suggest small business owners and entrepreneurs seriously consider including an arbitration clause in their employee handbook.

DISCLAIMERS

Disclaimers are a special category of clauses. Traditionally, they were placed at the beginning of the handbook and contained "nothing in this handbook is contractual" or an equivalent phrase. This is a generic disclaimer, and it could mean bad news for a company because its purpose is unclear. It is a disclaimer of everything included in the handbook and makes everything eligible for change, from insurance benefits to the mission statement to the disciplinary procedures. The problem is that some things, such as the legally mandated benefits, are undoubtedly contractual - that is, not subject to negotiations.

How to Use Disclaimers in an Effective Manner

Only place disclaimers where needed

In Secretary of State for Employment vs. Aslef, the court of appeals stated that some parts of the handbook would always be enforced, making them contractual, such as benefits required by law (Aikin, 1998). So a generic disclaimer that says nothing in the handbook is contractual would be inaccurate and, therefore, void. Procedures must be clearly labeled as contractual or not, or their meaning will be decided by the court that decides the case. So the disclaimer must be placed in the section to which it pertains and must clearly state that its validity is for that specific section only.

Use disclaimers consistently

In the case of Leahy vs. Starflo Corp. (see Martucci & Smith, 1997), the disclaimer included in Starflo's handbook was deemed inappropriate because it was not published in the "disciplinary procedure" section of the handbook and because the company privately stated that the disciplinary steps should be followed by all supervisors. If supervisors are told to follow every step of the procedure every time, then the procedure, not the disclaimer, is relied upon and followed, making the disclaimer false. The disclaimer must be followed and supported by all actions to be credible and upheld in a court of law.

Almost every employer is confronted with situations that require invoking disciplinary procedures. Because of their widespread use and the significance of using disclaimers in an effective manner, we discuss how to describe disciplinary procedures in the handbook and at the same time avoid any liability by incorporating disclaimers in an effective manner.

Disciplinary Procedures

Disciplinary procedures should be outlined in the handbook, but not in great detail and never as progressive steps that will be followed every time. If the disciplinary procedure is described as a series of progressive steps, then the employment will not be at-will, and termination of an employee for a first but serious offense will become extremely difficult. The employee could argue that the company failed to afford him/her due process - that is, did not use the step-by-step disciplinary procedure before terminating him/her.

Every handbook should contain a section on disciplinary procedures. To preserve the at-will employment relationship and at the same time have an effective and legally sound disciplinary procedure, organizations should follow the suggestions offered below.

Never list disciplinary procedures as a series of progressive steps (e.g., verbal warning, written warning, suspension, termination). Doing so implies that every step will be followed. Not every violation is going to get a simple verbal warning. For example, assault of a coworker is going to receive a harsher punishment than arriving five minutes late on one morning. The discipline section needs to make this point clear so people know what to expect. Make it clear that the consequences for infractions will depend on the nature of the infractions and are completely and entirely at the discretion of management. If on the other hand, the steps are described as progressive, employees will expect every step to be followed before they are terminated. If the employer does not follow the steps in the sequence listed in the handbook but terminates an employee for gross misconduct, then the employee could have a strong case against the employer for breach of contract.

The best alternative to listing disciplinary procedures as a series of progressive steps is to describe and depict the process as a cycle of possible actions. According to Falcone (1999), California courts have ruled that if the handbook implies there are specific steps in due process, the employment is no longer at-will, meaning a terminated employee can sue because a step in the list was skipped. If the procedure is created as a cycle, it may start at any point and progress to any other point. This representation helps when explaining that every step may not be followed and the inclusion of a step is only to show that it exists and is available for the management's use. To accomplish this, place all the options for discipline around the edge of a circle. Do not include a start or end point. They should not be placed in any specific order, as that would imply a steady progression. Then use the circle to decide which option would best fit each individual's misbehavior.

When describing and depicting the disciplinary process as a cycle of possible actions, be sure to include an "other" category as a possible action. Including such a category will be particularly important if the organization believes in adjusting the penalty to fit the crime. For example, if an employee walks out of the office with a company pen every day, the penalty could be to require the employee to bring in a new box of pens once a week. Although it may seem childish, adapting penalties to fit the misconduct can actually be an effective deterrent. This method works well with minor infractions that create an annoyance but are not yet problematic. It also is useful because it affords the small business owner the flexibility necessary to handle situations on an individual basis. Since it is impossible to foresee all possible infractions, providing the small business owner some discretion by leaving an "other" category of discipline makes sense.

Employers often list actions that would prompt disciplinary proceedings. If you list actions that will result in disciplinary proceedings, state very clearly that the list is illustrative and not exhaustive. That is, the list only contains a few of the possible actions that will be punished and the company reserves the right to punish any and all indecent and inappropriate behavior. This disclaimer is necessary to protect the company in cases where an employee engages in an inappropriate behavior that is not contained in the list. Using such a disclaimer is important because it is impossible to include every possible inappropriate behavior/action, and it protects a company's right to take action against employees who engage in inappropriate behaviors not included in the list of punishable behaviors and actions.

Why is use of disclaimers in the handbook important for small businesses? Consider the following scenario. As the owner of a small business you fire an employee because you suspect the employee is stealing money from the cash register. If you don't have an employee handbook and cannot document the theft, you are likely to have difficulty mounting a strong defense if the former employee alleges wrongful termination. If you had an employee handbook but had listed the disciplinary procedure in a step-by-step fashion (e.g., verbal warning, written warning), you could lose the case, especially if this were the former employee's first offense. On the other hand, if you had described the disciplinary procedure as a cycle of possible actions including termination, you are likely to have a much stronger case against the former employee. Thus, it makes sense for small businesses to use disclaimers. We urge small businesses to follow the recommendations we have offered on how to describe the disciplinary process and also list possible actions against infractions of company's policies and procedures.

ON-LINE EMPLOYEE HANDBOOKS

The increase in the availability and ease-of-use of new technology has resulted in many employers posting their handbook on the company's intranet or in a storage area on the internet. Organizations, particularly small businesses, must consider a number of issues before resorting to posting employee handbooks on-line. A few of the more important issues are discussed next.

First, employers, especially small business owners, have to realize that on-line handbooks may not be accessible to employees who do not have access to computers and/or the internet. Many employees do not use computers often enough to warrant purchasing one, so they would still need a written handbook to be provided. In addition, if the handbook is on the intranet, employees will not be able to access it from outside the company, so everyone will also need a written handbook. Employees who travel frequently may not have access so they would need a physical handbook. Basically, a physical handbook would have to be provided in addition to the net link. So, in most cases, it will not be possible for employers to only have an on-line version. Since hard copies may also be required, posting handbooks on-line does very little to eliminate the publishing and printing costs associated with the traditional (paper) employee handbook.

Second, changes employers make to a virtual handbook can be very hard to document. All employees need to somehow be notified that a change has been made and must somehow give their consent to the change. Documentation is important because a physical signed consent is easier to uphold in court than a reply to a mass email. In addition, if employees also have a printed version, updated sections must still be sent out to replace the old sections in the printed handbook because every employee cannot be expected to manually change the handbook. And if the change is not made and employees continue to use the printed handbook, they could be looking at outdated and invalid information. In the end, they could blame the employer for not providing the change in the handbook. Also, whenever changes are made, employers have to print the changes, affix a date to the changed material and store it. Because adjusting a virtual handbook is so easy, there is a chance the change would not be printed out, dated, and kept. That chance is risky because without the physical proof that a change had been implemented on a specific day, the employer could be required to follow the unchanged version.

Third, employers should be concerned with the security and integrity of the virtual handbook. Anyone can browse and read material on the internet. A password could be issued to access the handbook, but if someone wants to access it, they could figure out the password. If employees are allowed to print the on-line handbook, then the employer has no way of controlling who has that information about the company and cannot prevent an employee from taking that information with him/her after the employment relationship has ended. Also there is a chance of someone breaking through the security restrictions and making unauthorized changes to the handbook. If those changes are not caught right away, employees could follow them, possibly with disastrous results. Thus, the disadvantages far outweigh the advantages of using virtual handbooks, especially for small businesses. For these reasons, we strongly urge small business owners and entrepreneurs to not use online handbooks.

REVISING/UPDATING EMPLOYEE HANDBOOKS

Employers should periodically review the contents of the employee handbook. At a minimum, handbooks should be reviewed at least once a year. From time to time, it may become necessary to revise, update or add new policies, procedures and benefits. When making changes to the employee handbook, employers should engage in two very important actions.

First, they should print the section or sections that were revised, record the date the changes will go into effect, and make sure that every employee receives a hardcopy of the changes in a timely manner. It is always a good idea to require employees to read the revised sections and endorse their signature to acknowledge receipt and awareness of the changes made to the handbook.

Second, employers should provide "consideration" when substantive changes are made to existing policies or when a new policy is added to the handbook. Consideration must be given to employees in return for their signature of acceptance of a new handbook. Historically, courts have treated "continuing to work" as "acceptance" of the policy, but in a recent case, Doyle vs. Holy Cross Hospital, this precedent was reversed. The hospital had added a unilateral at-will doctrine to the handbook. When the plaintiffs were dismissed without a reasonable cause, they claimed they had never agreed to the at-will statement in the updated handbook. The court found for the plaintiffs, stating that they did not receive anything in return for giving up something. Therefore, a contractual agreement had not been made, and the plaintiffs were still employed under the old handbook (Jenero & Schreiber, 2000).

Thus, it is important for every business to periodically review the handbook, consider if updates or revisions are necessary, and evaluate if the changes merit use of "consideration." These issues are relevant to small businesses also because just like larger businesses, small businesses also grow in terms of number of employees and diversity of their operations. Such changes may require changes or revisions to the employee handbook.

CONCLUSION

Every organization must have an employee handbook. Employee handbooks are particularly valuable to small business owners. Small business owners can use the handbook to share core values with employees, improve morale, and negotiate affordable premiums for EPLI coverage. In addition, a well-designed handbook will most likely deter frivolous lawsuits; at the very least, it will serve as the first line of defense against lawsuits. Alternatively, not having a handbook or having a poorly designed handbook will become a damaging liability for a small business. In 1995, $35 billion was spent on litigation costs and rulings (Slate, 1995). A national survey conducted in 1997 found the median award in wrongful termination and discharge cases to be $162,500. The mean, which may be skewed by unusually high awards, was $461,745. These figures do not include attorney fees, which could be as high as $200,000. Punitive damages are awarded to over a third of discrimination and harassment claimants, and the amount of awards has been steadily increasing (McAndrew, 1999). By following the suggestions offered in this article, small business owners can develop an effective and legally sound employee handbook.

No handbook will be completely foolproof. However, the goal should be to foresee and eliminate as many potential problems as possible before they arise. In addition to following our suggestions, small business owners are advised to have an attorney check the handbook before it is published to catch legal errors and disputable areas. Such mistakes could present openings to employees to sue the company for creating false expectations, breach of contract, or wrongful termination. Legal advice will help avoid any problems that may have occurred unknowingly in the handbook making process. The farther a problem goes, the more costly it gets. In litigation, a company is lucky to get off with a warning and court costs. Most often, in addition to court costs, companies end up providing back pay and benefits, rehiring wrongful terminations, and paying punitive damages or corporate fines.

One simple error could mean hundreds of thousands of dollars in legal fees and litigation or arbitration. If a complaint makes it to court, the employee has more than a fifty-percent chance of winning. A single lawsuit could threaten survival of a small business. Remember: an ounce of prevention is worth a pound of cure. Prevent employee complaints by using suggestions offered in this article and by obtaining legal advice before publishing an employee handbook because, as stated above, the cure can be very expensive.

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A PROCESS MODEL OF BUSINESS PLAN DEVELOPMENT

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ABSTRACT

Current writing on the subject of business plan development almost uniformly follows an approach of asking an entrepreneur to use a template for a business plan or to answer numerous detailed questions regarding the various aspects of the proposed business. This method produces frustration on the part of many entrepreneurs because the templates or lists of questions do not follow the thinking processes that they engage in as they initially conceptualized the business and as they then begin to think through issues of operations, competition, finance, and others. As an alternative to the Template Model, this paper suggest a Process Model of business plan development that lays out 10 steps for the entrepreneur to follow either on his or her own or with a business advisor. These steps generally follow the more typical and more organic way that entrepreneurs develop business ideas and plans. The Process Model deals with key concepts first and then works toward developing the detail of a complete plan.

INTRODUCTION

Creating business plans is one of the most important functions that entrepreneurs engage in because business plans are often prerequisites for obtaining financial and other resources that entrepreneurs require for creating and growing their ventures. There is also a growing body of research that points to business plans as an effective tool for developing and monitoring internal business operations. Pedagogy for business plan creation is, therefore, one of the most important functions of entrepreneurship education programs. Most curricula in entrepreneurship include courses or programs in the development of business plans and there are numerous books on the subject.

Most approaches to business plan creation use what I will call the Template Model. In this approach the author of the business plan follows an outline, or template, and basically goes through the outline filling in the blanks. Sometimes these templates are converted into lists of questions such as "How much debt do you expect to raise?" or "How much would you like to earn from your business?" While there are certain plusses to this template approach, such as quickly introducing the entrepreneur to many issues that will need attention, it often leads to frustration on the part of the entrepreneur and, ultimately, to plans that read like copies of previous plans for other businesses often from distant industries. It often seems to me that answering questions like these early in the process of plan development are like being asked to produce a shopping list for cooking a meal before you have decided what to cook.

The alternative to the Template Model is an approach that follows the more logical process of thinking, analysis, and strategic planning that goes into business plan development that I will call a Process Model. In my experience working with hundreds of entrepreneurs, teaching courses on business plan development, interviewing funding sources such as bankers, venture capitalists, and angel investors, and writing on the topic, the Process Model represents a more organic approach that leads to less frustration, higher rates of plan completion, and, most importantly, better, more compelling plans.

The purpose of this article is to review the literature on business plans including their use and value, detail and give some examples of the Template Model, and propose a detailed Process Model for business plan creation.

The Planning Function for Entrepreneurs

The value of planning is demonstrated best by looking at a profession in which virtually all the work is planning, for example architects. Architects develop plans that are usually executed by others professions for structures that are paid for and lived in by the client. Yet, new structures or modifications to existing structures of more than minimal scale are rarely carried out without the plans produced by architects. There are several reasons for this. First, projects requiring government approvals or permits often mandate architect-certified plans. Second, building projects require many decisions and specifications and it is easier, faster, and cheaper to make these decisions on paper or on a computer screen than by rearranging actual buildings, steel girders, or bricks once the building project has begun. Finally, and perhaps most importantly, planning allows for testing the viability and safety of structures in a cost effective manner. Prior to the development of scientifically based architecture tools, innovative structures such as cathedrals met or failed their test of soundness only after being built – and many failed that test.

Entrepreneurial ventures can benefit similarly from planning. First, investors, lenders, and the Small Business Administration serve a similar role to both the consumers and government agencies, requiring plans before giving their approvals to investments and loans. Second, budgeting on paper or a spreadsheet allows for the myriad of decisions (and their complex interactions) that an entrepreneur must make such as hiring, marketing, capital investment, and many more to be observed and tested in a virtual and no-risk environment before being tried in reality. Finally, there is growing evidence that planning actually leads to lower rates of business failure, just as it did for buildings.

Research on Planning

There is surprisingly little research that goes directly to the issue of whether formal business plans increase positive business outcomes generally and virtually none directly related to entrepreneurs. Research currently being carried out at the Lawrence N. Field Center for Entrepreneurship and Small Business at Baruch college that tracks start-up rates for aspiring entrepreneurs, preliminarily points to much higher actual start-ups among those who complete business plans, but part of this preliminary result could be related to the fact that people who abandon business ideas or decide to pursue other career paths have no need to complete a plan. Longer term data which is in the process of being collected will show if people who completed plans have higher success rates or greater business growth in business than those who started businesses without plans. Again, the preliminary data point to positive effects of plan creation.

Perry (2001) examined matched samples of firms that entered formal bankruptcy and those that did not and compared them with regard to how much formal business planning was engaged in by each category. Overall, Perry concluded that all firms engaged in little formal planning, but that the firms that failed engaged in less than the firms that did not fail. A recent study by Gibson and Cassar (2002) found that engaging in formal planning correlates with variables such as firm size, owner's education level, training, and intention to change. But this study does not address the long or short-term effects of planning on firm performance. Berman et al. (1997) found a positive relationship between financial planning and growth while O'Neill et al. (1987) failed to show any relationship between formal planning and performance.

One of the limitations of the research is that much of it defines planning in the broadest sense and does not focus on the creation of business plans by entrepreneurs. Nonetheless, as a normative matter, management and entrepreneurship writers continue to strongly recommend that entrepreneurs engage in significant, formalized planning. Examples of this include Timmons (1999), Longenecker, et al. (1994), Stevenson et al. (1999), and Scarborough and Zimmerer (2003).

METHODOLOGY

This study grows out of several qualitative research approaches to this subject. First, the literature on business plan development was reviewed. This literature is summarized in the previous section to this paper. Second, virtually every textbook and trade book on the subject of business plan creation was reviewed. Without exception, all the existing books on the subject rely on a template model as described below. Third, I taught graduate and undergraduate level classes on business plan creation for eight years, bringing me into contact with more than 350 students going through the process of creating a business plan for their course project. Fourth, I worked as a Faculty Mentor in an entrepreneurship center. In this capacity, I worked with several hundred business owners and aspiring entrepreneurs who were creating business plans.

This qualitative research approach lead me to a clear conclusion that template models were producing frustrations among students and business owners who were writing business plans, regardless of the books or other materials that they used.

During this experience, I began to extensively interview those who were writing plans to see the origins of their frustration and to discern their thought processes. This lead to a conclusion that a more deductive, process model would better match the thinking that went into the formulation of business ideas and then to their specific plans. In all, 63 of these open-ended interviews took place over a two-year period.

Finally, I began to create materials that more closely matched this deductive process that aspiring entrepreneurs were following. Throughout this interviewing period, the process model as presented below was refined and finalized through use with more than 150 people who were developing business plans. My subjective observations are that the level of frustration decreased and the speed at which the plans were completed increased.

THE TEMPLATE MODEL

The Template Model of business plan development gives the entrepreneur an outline of a plan or a list of questions to answer. Often it gives both an outline and list of questions. The textbooks listed above all give outlines, and, with the exception of the Stevenson text which has less of emphasis on business plan creation, they all give questions. The Timmons text also gives a detailed personal inventory questionnaire before taking its readers into business plan creation. Typically, these books give their readers approximately 100 headings under the business plan outline and an equal or greater number of questions on various lists broken out by functional areas of management such as finance, organization, or marketing.

In my experience there is nothing wrong with the content of the outline or the questions, but the structure of the process of creating a plan from a template does not follow how entrepreneurs think about creating their business. Generally, I see people who have a concept that evolves through various stages of growing complexity and detail into a full plan. The result of attempting to answer the questions or follow the template that takes into great detail too soon is that the entrepreneur becomes discouraged soon after starting to work on the template or are forced to answer questions out of sequence, meaning before they have addressed the underlying strategies. For example, without having arrived at a strategy and understanding of one's competitive advantage it is difficult to address most marketing questions.

Table 1 is a simple outline given on the Small Business Administration website that demonstrates this and is generally typical of what is seen in most entrepreneurship books that cover the subject of business plan development.

Table 1
Outline for a Business Plan Provided the U.S. Small Business Administration

Introduction	
o	Give a detailed description of the business and its goals.
o	Discuss the ownership of the business and the legal structure.
o	List the skills and experience you bring to the business.
o	Discuss the advantages you and your business have over your competitors.

Table 1
Outline for a Business Plan Provided the U.S. Small Business Administration

Marketing	
o	Discuss the products/services offered.
o	Identify the customer demand for your product/service.
o	Identify your market, its size and locations.
o	Explain how your product/service will be advertised and marketed.
o	Explain the pricing strategy.
Financial Management	
o	Explain your source and the amount of initial equity capital.
o	Develop a monthly operating budget for the first year.
o	Develop an expected return on investment and monthly cash flow for the first year.
o	Provide projected income statements and balance sheets for a twoyear period.
o	Discuss your breakeven point.
o	Explain your personal balance sheet and method of compensation.
o	Discuss who will maintain your accounting records and how they will be kept.
o	Provide "what if" statements that address alternative approaches to any problem that may develop.
Operations	
o	Explain how the business will be managed on a day-to-day basis.
o	Discuss hiring and personnel procedures.
o	Discuss insurance, lease or rent agreements, and issues pertinent to your business.
o	Account for the equipment necessary to produce your products or services.

Table 1 **Outline for a Business Plan Provided the U.S. Small Business Administration**	
o	Account for production and delivery of products and services.
Concluding Statement	
o	Summarize your business goals and objectives and express your commitment to the success of your business.

Table 2 presents a list of questions the same SBA website suggest answering as part of developing a marketing plan.

Table 2 **Questions for the Entrepreneur Provided the U.S. Small Business Administration**	
Develop a marketing plan for your business by answering these questions. (Potential franchise owners will have to use the marketing strategy the franchisor has developed.) Your marketing plan should be included in your business plan and contain answers to the questions outlined below.	
o	1. Who are your customers? Define your target market(s).
o	2. Are your markets growing? steady? declining?
o	3. Is your market share growing? steady? declining?
o	4. If a franchise, how is your market segmented?
o	5. Are your markets large enough to expand?
o	6. How will you attract, hold, increase your market share? If a franchise, will the franchisor provide assistance in this area? Based on the franchisor's strategy? how will you promote your sales?
o	7. What pricing strategy have you devised?

I have seen many business owners and aspiring entrepreneurs attempt to address these questions and become quickly frustrated because they have not yet addressed the fundamental, conceptual issues that must underlie every business. Virtually every business plan textbook or pamphlet takes this same approach.

THE ALTERNATIVE: A PROCESS MODEL OF BUSINESS PLAN CREATION

In working with hundreds of business owners and aspiring entrepreneurs as they go through the process of creating business plans, I have seen the frustrations that they encounter as they face a template of an outline or a long list of detailed questions. The Process Model that I present below, strives to proceed from the general to the specific while at the same time moving from issues of how the business will be of service to others to what the business will need from others to be successful. I believe that this approach can be used in one-on-one counseling or in a classroom setting and will lead to higher quality plans more quickly than the Template Model.

Step 1: Define The Company: What will it accomplish for others?

Defining the company consists of specifying the needs that the company will satisfy for its customers. Entrepreneurs tend to define their ventures in terms of what it will accomplish for them, but ultimately this is irrelevant to getting customers, lenders, investors, or partners. Potential investors need to know that that the business will be meaningful and marketable to people who can use your product or service. Therefore, this step concentrates on the external needs that will be met. Examples of these include a product or service that enable people to do something better, more cheaply, more safely, or more efficiently.

Step 2: Identify The Venture's Initial Needs: What will the venture require to get started?

Whether an entrepreneur wants to buy an existing company with 300 employees or you can start a business by only adding an extra phone line to a home office desk, they need to make a list of the needed materials. Some may be tangible, such as five hundred file folders and a large cabinet in which to store them all. Other requirements may be intangible, such as time to create a product design or to do market research on potential customers. One venture may require hiring an assistant to develop a retrievable filing system for the five hundred folders, or hire a consultant to set up a computer system that's beyond your technical skills.

If the entrepreneur is going to build a better mousetrap, he or she may have constructed a prototype out of used toothpaste tubes and bent paperclips at home, but will need a sturdier, more attractive model to show potential investors. What exactly will your mousetrap look like? What materials will be needed? Does it require money for research and development to improve on the original toothpaste tube and paper clip construction? Does it need to hire an engineer to draw up accurate manufacturing designs? If the entrepreneur wants to open a restaurant, he or she will have to figure out how much money will be needed to cover rent, equipment and renovations before turning a profit. This step involves doing a great deal of homework such as calling real estate brokers and looking at actual potential spaces.

Step 3: Choosing A Strategy: How will one distinguish the product or service from others?

Although there are millions of types of businesses, there are actually only a few basic strategies that can be applied to make any enterprise successful. It is important to see the strategic options and understand the reasoning behind the selection of one over others. The first step in selecting an effective strategy is for the entrepreneur to identify a competitive advantage for his or her product or service. How will they establish that their product or service is better, cheaper, more delicious, or more convenient? Competitive advantage may include designing special features not found in rival products. It may entail superior service characteristics such as speedier delivery, a lower price, or more attentive sales people.

Suppose an entrepreneur wants to open a restaurant that serves squid flavored pancakes. What will its competitive advantage be? Do people in the neighborhood devour other squid based dishes and can't seem to get their fill? Have all the other pancake restaurants in the community failed to include squid flavored items on their menus? Is squid much cheaper to acquire than other more traditional pancake ingredients, such as bananas? Will that enable the business to charge much less for all the items on your menu, including banana pancakes? Will the decor of the restaurant be so enticing to squid lovers that they'll come in to look around and then discover how delicious your squid pancakes can be?

In short, the entrepreneur must have a reason why the business will succeed. This is the competitive advantage and once there is a competitive advantage established, a strategy can be selected.

Step 4: Analyze the Potential Markets: Who will want the product or service?

In this step, the entrepreneur defines the target market for the business' product or service, covering such issues as age, gender, profession, ethnicity, race, economic characteristics, location, and size. Once the target market is defined then the entrepreneur can research the numbers: How many car mechanics, house painters or bathroom contractors are there in any given community? How many children in the United States are currently under the age of eight? How much soap will they use in a month or a year? How many other soap manufacturers already have a share of the market? How big are the potential competitors? Identifying the target market is one of the great satisfactions of starting one's own business. At this stage, entrepreneurs are thinking about the actual people who will use their product or service.

Step 5: Develop a Marketing Campaign: How will the business reach customers and what will be the message?

Entrepreneurs, especially inventors, often believe that their business concept is so spectacular that promoting their product or service won't be necessary. Sort of a "build it and they will come" attitude, especially if what you're building is the proverbial better mousetrap. One of the most common flaws I see in plans is the entrepreneur's failure to describe exactly how customers will be reached and how products will be presented to them. Potential investors, staff, and partners won't be convinced that an idea can succeed until there are established well-researched and effective methods of contacting customers – and the assurance that once they are reached, they can be convinced to buy the product or service.

Suppose hypothetically an entrepreneur wants to open a financial services business to advise Wall Street investors who wish to buy stocks in the rubber sole industry. The entrepreneur already identified the target market as major New York City based investors interested in rubber sole stocks and the competitive advantage as the entrepreneur's unparalleled expertise in rubber sole stocks.

Some of the questions that have to be answered to develop a marketing campaign include: What trade journals and newspapers do potential clients read? Would ads in these publications be worth the cost of placing them? How could one interest a reporter for one of these periodicals in writing a story about this new advisory firm? Is there an organization of rubber sole company investors that the entrepreneur should join? Are there conventions for investors in rubber sole companies that would be worth attending?

Step #6: Build A Sales Effort: How will the business attract customers?

The word "sales" covers all the issues related to making contact with actual customers once the entrepreneur has established how to reach them through the marketing campaign. How will the sales staff be trained to approach potential customers? Will the sales staff be divided up so some become experts in selling one or a few types of customers? What advertising and promotional efforts will be employed?

In planning sales activities, the entrepreneur also needs to answer questions such as: Is it ethical to contact colleagues and clients from his or her former job? Will the entrepreneur be the only salesperson in the beginning stages of the company? When will he or she know it's time to hire additional sales staff? What will the basic sales philosophy be – building long-term relationships with a few major clients or developing a clientele of many short-term customers?

The entrepreneur will also need to consider how you will compensate the sales staff – with a base salary plus a commission or just a commission? Knowledge of the competitive advantage is just as important in designing a dynamic sales effort as it is in developing an effective marketing campaign. The entrepreneur needs to think about what product or service qualities will be the most compelling to prospective customers. Then he or she has to devise convincing language that clearly communicates this competitive advantage to the sales staff who will in turn use it when talking to customers. In my experience, the most important element of an effective sales effort is having a sales staff that thoroughly understands the business and the needs or potential customers. Therefore, the sales plan must address the issue of how to create a sales staff that is as knowledgeable about your business as it is about your potential customers.

Step # 7: Design the Company: How will the business hire and organize its workforce?

By the time the entrepreneur has reached the stage of thinking about the potential business concept, he or she probably has a good idea of the number of people they will need and the skills they will require to get the enterprise up and running.

The entrepreneur needs to focus on establishing that he or she capable of running the business. Perhaps they are not, and need to bring in experienced managers. They need to know where they will find these potential employees.

The entrepreneur will need to specify the key management jobs and roles. Positions such as president, vice presidents, chief financial officer, and managers of departments will need to be defined along with stating who reports to whom. Many people may hope to run their companies as one big happy family – and it may work out that way – but organizations require formal structure and investors will expect to see these issues addressed ultimately in a plan.

Issues such as how to find the right consultants, whether the entrepreneur will collect a salary, when will it be time to hire a staff, what skills must they have, how will they be recruited them, and how will the company be structured so the chain of command and quality control are maintained if the company grows dramatically, all need to be thought through.

Step # 8: Target the Funding Sources: Where will the financing come from?

As the business concept begins to take shape, the entrepreneur can begin to hone in on the most likely financing sources. Issues such as the size of the business, the industry it is in, whether it is a start-up the purchase of an existing business, and whether the entrepreneur can provide collateral to a lender are among the issues that must be considered in creating a target list of funding sources. Banks and other funding sources don't lend money because people with interesting business ideas are nice. The entrepreneur needs to see that lenders and investors follow specific guidelines which are designed to insure that they will make money by investing in or lending to a business.

For the vast majority of entrepreneurs, the well-known, high profile means of raising money, such as through venture capital companies or by going public, are not viable options. Their own credit, credit rating, and business history are key factors in obtaining financing for your venture through Small Business Administration (SBA) guaranteed loans and other bank credit. Their ability to tap into a personal network of friends, family, and professional contacts is crucial to raising money beyond what their own personal funds or credit can provide. In all of these cases, there are important considerations such as the potential impact on relationships when family and friends become investors.

When the process of identifying the likely potential funding sources and writing a bankable business plan that addresses their needs and answers their questions, then the entrepreneur will have greatly increased the likelihood of obtaining the needed financing.

Step # 9: Detail and Explain the Financial Data: How others be convinced to invest in this endeavor?

The accuracy of the financial projections is absolutely critical in convincing investors, loan sources and partners that the business concept is worthy of support. The data must also be scrupulously honest and extremely clear. Since banks and many other funding sources will compare your projections to industry averages in the Risk Management Association (RMA) data, it is important to use the RMA figures to test projections before the bank does. Numbers will be more credible if they compare reasonably to the industry averages.

The actual number crunching portion of the business plan is not the place to talk about pie-in-the-sky hopes for opening an office in every country around the globe or for convincing the U.S. Army that the squid flavored pancakes should become standard fare in all military mess halls. It's the place to discuss how and why certain equipment is needed, how much these items will cost, when the business expects to turn a profit, and how much return and other benefits investors will receive.

The most common reason new businesses fail is simply because they run out of cash reserves. Investors lose confidence in the entrepreneur and the business and become reluctant to make additional investments when projections are not met. Had the projections been less optimistic and the investors asked to invest large amounts in the beginning, they probably would have done so. In most cases, proper planning and more accurate projections could have avoided this problem completely.

A business plan should clearly state the amount of funds you need, how soon they are required, and how long before g investors will be repaid. By the time the entrepreneur has pulled together all the important financial data, he or she will have a clearer picture of how much money they will need to borrow, how much of their own funds they will be able to commit, and the amount of investments they will have to secure. This is also a good time for the entrepreneur to take a crash course in accounting principles or learning how to create spreadsheets on a computer program.

Step # 10: Showing the Entrepreneur in the Best Light: What are his or her qualifications for bringing this plan to fruition?

The talents, experience and enthusiasm each entrepreneur brings to their enterprise are unique. They provide some of the most compelling reasons for others to finance a business. The entrepreneur needs to keep in mind that investors invest in people more than ideas. Even if your potential business has many competitors or is not on the cutting edge of an industry, the qualifications and commitment the entrepreneur demonstrates in the plan can convince others to proffer their support.

The entrepreneur's resume will be included in the separate appendix of exhibits at the end of the plan, so the body of the plan is not the place to list every job he or she ever had or the fact that they were an art history major in college, especially if these experiences have no direct bearing on the ability to start a business. But it is the place to emphasize qualifying skills that may not be readily apparent from a resume.

Say the entrepreneur wants to open the restaurant featuring squid flavored pancakes. Investors won't be initially impressed by a long and successful career as a commercial airline pilot. They may be much more swayed by the fact that from the age of eight to eighteen, he worked after school and weekends in your father's delicatessen. This information has probably never appeared on your professional resume, which stresses the number of flying hours logged, an outstanding safety record and the citations received for the most on-time flights. But having worked for so long and intimately in a family-owned retail food business indicates that the aspiring entrepreneur knows how to supervise cooks, run a cash register, and order perishable foodstuffs in bulk.

Of course, the entrepreneur should not overlook the impact being a pilot may have on his ability to run a restaurant, especially if those skills are not apparent to potential investors. He should stress that you know how to supervise a crew of people working together to make a group experience if not comfortable, at least safe. Pilots have undoubtedly handled dissatisfied or enraged customers. Even that BA degree in art history may enable someone to teach cooks how to make their dishes more appealing to the eye. If the business requires partners or staff, the entrepreneur must be prepared cover the same issues for them.

CONCLUSION

As a normative matter and based on numerous anecdotal experiences of businesspeople and academics in the field of entrepreneurship, it is generally accepted that engaging in formal business plan development is an important precursor to success for entrepreneurs. While long term studies with statistically significant broad samples is not yet available, it is likely that such studies will confirm this finding. If nothing else, it is currently true and will likely remain true well into the future that a formal business plan is a necessary document required by investors, lenders, partners, and government agencies. Yet, the methodology offered to aspiring entrepreneurs and existing business owners for the creation of such plans is often difficult to maneuver and manage.

This article proposes an alternative approach to the Template Model that relies upon detailed outlines, questionnaires, or both. This alternative approach is called the Process Model of business plan development and takes the entrepreneur from the conception stage to more detailed stages of plan development based on the thought processes that I have observed entrepreneurs engaging it. As currently formulated, it has ten stages with the development of detailed financial projections coming towards the end of the process after key strategic, management, and marketing issues have been addressed.

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THE FACT AND THE FANTASY OF I.R.C. §1202: AN ILLUSTRATIVE OVERVIEW AND ANALYSIS

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ABSTRACT

Graduate and undergraduate tax courses spend a considerable amount of classroom and research time exploring the capital structure of corporations. Often included in this discussion are topics that relate specifically to small businesses. This is particularly relevant in that Congress has frequently sought to provide incentives to encourage the investment in small businesses. The formation of the Small Business Administration to provide loans and business expertise is one example. Other instances of Congressional incentives to small business investors are manifested in provisions enacted into the Internal Revenue Code (I.R.C.). For example, the creation of the Subchapter S election allows small business owners to obtain the benefits of incorporation without the impact of double taxation on profits. The enactment of I.R.C. §1244 in 1958, designed to partially eliminate the inequities caused by the limitations on capital loss deductions, provides another instance of legislative encouragement to invest in small businesses. A purported major small business investment incentive contained in the current tax law is I.R.C §1202. This provision was intended to provide noncorporate taxpayers with a significant investment incentive by allowing the exclusion of up to 50 percent of the gain on the sale of qualified small business stock (QSBS) if certain requirements are met.

Most textbooks are by necessity limited in not only their discussion and illustration of taxpayer incentives relative to small businesses but whether or not the

incentives actually exist. This is particularly true with respect to I.R.C. §1202. The textbook limitation often leaves students confused and uncertain as to how the provisions of I.R.C. §1202 are to be applied and the taxpayer benefits actually achieved. This is even more evident in more complex cases such as where a different interpretation of the gain limitation can affect the amount of the exclusion, when the QSBS was acquired in an I.R.C. §351 exchange involving the contribution of appreciated property by the taxpayer, and the highly negative impact on tax savings that results from the alternative minimum tax (AMT). Teaching the real world tax consequences to taxpayers of I.R.C. §1202 and utilizing more complicated and real-world oriented scenarios provides the tax instructor and students with several benefits. Foremost among these benefits is the ability to further enhance student concepts beyond those contained in the text in a manner that challenges student problem solving and conceptual skills. In addition, the need for tax research and planning is clearly delineated by the tax benefits, or lack thereof, obtained through the understanding and successful application of this Code provision.

This paper provides a brief overview of the requirements for QSBS status, the difficulty of interpreting the restrictions on the amount of gain exclusion under I.R.C. §1202, the impact of the alternative minimum tax, and the adjustments necessitated by the appreciated property rule. The application of I.R.C. §1202 is then illustrated through teaching scenarios of progressing difficulty.

THE BASICS OF I.R.C. §1202

To encourage and reward individuals for taking the risk of investing in small businesses, Congress, as part of the Revenue Reconciliation Act of 1993, created a new tax incentive. This incentive, contained in I.R.C. §1202, significantly rewards taxpayers by providing an exclusion of up to 50 percent of the gain on the sale of QSBS held for more than five years (I.R.C. §1202(a)). The gain not excluded is taxed at the capital gains rate of 28 percent (I.R.C. §1(h)(5) and (8)). The effect of this provision is to impose a maximum tax, ignoring the impact of the alternative minimum tax, of 14 percent (50% x the 28% capital gain rate) on the I.R.C. §1202 gain. This rate provides a substantial tax savings over the 20 percent rate that might apply to other types of income received by the taxpayer. However, to obtain these benefits, certain requirements must be met and certain limitations are placed on the maximum amount of the gain to which the exclusion can apply.

Qualified Small Business Stock Eligibility

In order to be considered QSBS, the stock must have been issued by a C corporation after 1993 (I.R.C. §1202(c)(1)) and must have been acquired by the taxpayer at its original issue in exchange for money or other property or as compensation for services provided to the corporation (I.R.C. §1202(b)). In addition, the issuing corporation must have met the active business requirement and the gross assets test.

Meeting the Active Business Requirement

To qualify as QSBS, the issuing corporation must have been engaged in an active trade or business during substantially all of the taxpayer's holding period for the stock (I.R.C. §1202(c)(1)(A)). Furthermore, the issuing corporation must use at least 80 percent of the value of the corporation's assets in the active conduct of a qualified trade or business (I.R.C. §1202(e)(1)(A)). Any trade or business is considered to be qualified unless it is specifically excluded. Activities that are specifically excluded are service providers (such as law, engineering, accounting, etc.), banking, insurance, financing, leasing, investing, farming, extractive, hotels/motels, and restaurants (I.R.C. §1202(e)(3)). The active business requirement is waived for specialized small business investment companies (corporations licensed by the Small Business Administration under Section 301(d) of the Small Business Investment Act of 1958).

Meeting the Gross Assets Test

The issuing corporation's gross assets must be $50 million or less immediately before and after the stock is issued (I.R.C. §1202(d)(1)). Should the issuing corporation's assets exceed $50 million after the issuance of the stock, stock already issued will continue to be QSBS. However, once the $50 million limitation has been exceeded, the corporation will not be permitted to again issue stock that will qualify as QSBS (I.R.C. §1202(d)).

Limitations on the Amount of the I.R.C. §1202 Gain Exclusion

As previously noted, 50 percent of a taxpayer's gain on the sale of I.R.C. §1202 stock may be excluded. However, a per-issuer limitation is imposed on the amount of the gain to which the exclusion can be applied. The gain limit is the greater of 10 times the aggregate adjusted basis of the stock or $10 million. This limitation is reduced by the amount of gain excluded by the taxpayer on sales of the corporation's stock in previous years (I.R.C. §1202(b)). The exact wording of the code is, however, quite ambiguous and two distinctly different interpretations are currently in use. A restrictive interpretation would have the code allowing an exclusion of gain up to a maximum of 50 percent of $10 million (resulting in a maximum exclusion of $5 million) or 10 times the aggregate adjusted basis of the stock (resulting in a maximum exclusion of 5 times the adjusted basis of the stock), whichever is greater. A more aggressive interpretation would read the limitation provision to allow a maximum exclusion of $10 million or 10 times the aggregate adjusted basis, whichever is greater. While both approaches are currently used by taxpayers with the restrictive approach being more common, no textbook presents both or even alludes to the existence of an alternative interpretation. To date the Internal Revenue Service has not issued any regulation to clarify the issue.

I.R.C. §1202 AND THE APPRECIATED PROPERTY RULE

The formation of a small business frequently entails the contribution of property, other than money or stock, in exchange for the stock of the newly formed entity. Under I.R.C. §351 a carryover basis is permitted to the corporation and neither the shareholder nor the corporation recognizes a gain on the transaction. Unfortunately, the appreciated property rule can significantly affect the new small business corporation in two ways. First, when determining whether the aggregate gross assets are $50 million or less immediately before and after the issuance of stock, the corporation must use the fair market value of the contributed assets at the time of the contribution - not the carryover basis permitted under I.R.C. §351. Secondly, and perhaps more importantly, for purposes of the I.R.C. §1202 exclusion, if the stock was acquired by transferring appreciated property to the corporation, a separate calculation is required. For I.R.C. §1202 purposes only, the basis of the stock in the hands of the shareholder is deemed to be fair market value of the property at the date of transfer (I.R.C. §1202(i)(1)). For many taxpayers who transfer appreciated property, this will result in the overall gain on the subsequent disposition of the stock being greater than the gain allowed in computing the I.R.C. §1202 exclusion.

THE IMPACT OF THE ALTERNATIVE MINIMUM TAX

Unfortunately, what Congress and the Internal Revenue Service give with one hand, they can take away with the other. This is readily apparent in that, under I.R.C. §57(a)(7), 42 percent of the gain excluded under I.R.C. §1202 is considered a tax preference item under the alternative minimum tax (AMT). The current AMT rates are 26 percent of the first $175,000 of alternative minimum taxable income and 28 percent on amounts in excess of $175,000 (I.R.C. §55(b)(1)(A)). For QSBS whose holding period begins after December 31, 2000, only 28 percent, rather than 42 percent, of the excluded gain is considered a tax preference item (I.R.C. §57(a)(7)).

The negative impact of the AMT on the benefits of I.R.C. §1202 is quite substantial. In many cases the effective tax rate, considering the AMT, rises to 19.9 percent. This is only marginally betterthan the 20 percent long-term capital gain rate that would apply if the taxpayer did not utilize the provisions of I.R.C. §1202. Thus, for most cases the fantasy of large tax savings is eliminated by the fact of the AMT. For illustrative purposes, it is assumed that the maximum AMT rate of 28 percent applies to all scenarios.

PROGRESSIVE SCENARIOS ILLUSTRATING I.R.C. §1202

The following scenarios will serve to provide progressive illustrations of I.R.C. §1202. The data set of the first scenario will be modified in subsequent scenarios to illustrate the difficulties of determining the amount of the exclusion under I.R.C. §1202 and the application of the appreciated property rule. Each of the scenarios will calculate the tax impact from the sale of the stock with and without the impact of the AMT to illustrate the fantasy to reality effect of the additional tax.

Scenario 1

Gain Is Less Than Exclusion Amount and Appreciated Property Rule Does Not Apply

Jack and Mary Smith started a small business in January of 1997, Cajun Inc. The business, located in Lafayette, Louisiana, was organized as a C corporation. The Smiths received 100 percent of the 10,000 shares, in Cajun Inc. by transferring property that had both basis and fair market value (FMV) of $2,000,000. The transfer qualified as a nontaxable exchange under I.R.C. §351 and the stock is considered qualified small business stock under I.R.C. §1202. The business has been very successful since its incorporation.

In January of 2003, the Smiths received an offer to sell all of their stock in Cajun Inc. for $8,000,000. The Smiths have decided to accept the offer. What are the tax ramifications to the Smiths?

Table 1	
Scenario 1: Gain Is Less Than Exclusion Amount And Appreciated Property Rule Does Not Apply	
Amount Realized	$ 8,000,000
Basis of Stock:	
Adj. Basis - §1001	$ 2,000,000
FMV - §1202	$ 2,000,000
Total Gain Realized	$ 6,000,000
Gain Realized - §1202	$ 6,000,000
Gain Subject to §1202 Exclusion:	
Lesser of:	
(a) §1202 Gain	$ 6,000,000
Or	
(b) Greater of:	
(1) $10,000,000	$10,000.000
Or	
(2) 10 x §1202 Basis	$20,000,000
§1202 Exclusion:	
[50% of Smaller of (a) or (b)]	$ 3,000,000
Gain Equal to Exclusion Taxed at 28%	$ 3,000,000
Tax @ 28%	$ 840,000
Gain in Excess of Exclusion Taxed at 20%	$ -0-
Tax @ 20%	$ -0-
Total Tax Without AMT	$ 840,000

Table 1	
Scenario 1: Gain Is Less Than Exclusion Amount And Appreciated Property Rule Does Not Apply	
Effective Tax Rate:	
($840,000/$6,000,000)	14 percent
Minimum Tax Saving:	
[($6,000,000 x 20%) - $840,000]	$ 360,000
Tax Impact of AMT:	
Tax Preference:	
(42% x $3,000,000 Exclusion)	$ 1,260,000
AMT Tax (28% x $1,260,000)	$ 352,800
Total Tax Including AMT:	
($840,000 + $352,000)	$ 1,192,800
Effective Tax Rate with AMT:	
($1,192,800/$6,000,000)	19.9 percent
Tax Savings with AMT:	
[($6,000,000 x 20% - $1,192,800)	$ 7,200

Solution

The Smiths will have a realized gain on the sale of $6,000,000 ($8,000,000 sales price - $2,000,000 adjusted basis in stock). Under I.R.C. §1202, the Smiths can exclude upto 50 percent of the gain on the sale or $3,000,000. The exclusion is calculated by comparing the gain of $6,000,000 to $20,000,000 (the greater of $10,000,000 or $20,000,000 (10 x the adjusted basis of $2,000,00), selecting the smaller and multiplying by 50 percent. Since the gain is below the maximum limitations, the restrictive approach, illustrated above, and the aggressive approach would be the same under either approach. The non-excluded gain of $3,000,000 will be taxed at the long-term capital gains rate of 28 percent. Thus, the Smiths will have a tax liability (ignoring the AMT) on the sale of $840,000 ($3,000,000 gain x 28%) resulting in an effective rate of 14 percent ($840,000/$6,000,000 gain). The minimum tax savings, excluding the AMT, is $360,000 (($6,000,000 x 20%) - $840,000).

Unfortunately, most taxpayers will have their tax liability impacted by the AMT. I.R.C. §57(a)(7) requires that 42 percent of the excluded gain be treated as a tax preference item subject to a maximum AMT rate of 28 percent. Thus, the tax liability of the Smiths could be increased by as much as $352,800 ($3,000,000 exclusion x 42% x 28%) resulting in a total tax liability of $1,192,800 ($840,000 + $352,800). The effect of the AMT would be to reduce the minimum overall tax savings from a fantasy of $360,000 to a fact of $7,200 (($6,000,000 x 20%) - $1,192,800) and result in an effective rate of 19.9 percent ($1,192,800/$6,000,000) which is not significantly below the long term capital gain rate of 20 percent that would be available without the existence of I.R.C. §1202. While the AMT preference rate will be reduced from 42 percent to 28 percent for stock whose holding period begins after December 31, 2000. Table 1 presents the preceding analysis in a tabular form.

Scenarios 2A and 2B

Gain Is Greater Than Exclusion Amount and Appreciated Property Rule Does Not Apply

All the facts from Scenario 1 are retained except that the stock is now sold for $25 million. Scenario 2A uses the restrictive interpretation of the limitation which views the I.R.C. §1202 exclusion as being limited to an amount not greater than 50 percent of the greater of $10,000,000 or 10 times the adjusted basis of the stock. Scenario 2B takes the more aggressive interpretation that 50 percent of the I.R.C. §1202 gain, not to exceed $10,000,000 or 10 times the adjusted basis of the stock, can be excluded.

Table 2	
Scenario 2a: Gain Is Greater Than Exclusion Amount And Appreciated Property Rule Does Not Apply (Restrictive Interpretation of Exclusion Rule)	
Amount Realized	$25,000,000
Basis of Stock:	
Adj. Basis - §1001	$ 2,000,000
FMV - §1202	$ 2,000,000
Gain Realized - §1001	$23,000,000

Table 2	
Scenario 2a: Gain Is Greater Than Exclusion Amount And Appreciated Property Rule Does Not Apply (Restrictive Interpretation of Exclusion Rule)	
Total Gain Realized - §1202	$23,000,000
Gain Subject to §1202 Exclusion:	
Lesser of:	
(a) §1202 Gain	$23,000,000
Or	
(b) Greater of:	
(1) $10,000,000	$10,000.000
Or	
(2) 10 x §1202 Basis	$20,000,000
§1202 Exclusion:	
[50% of Smaller of (a) or (b)]	$10,000,000
Gain Equal to Exclusion Taxed at 28%	$10,000,000
Tax @ 28%	$ 2,800,000
Gain in Excess of Exclusion Taxed at 20%	$ 3,000,000
Tax @ 20%	$ 600,000
Total Tax Without AMT	$ 3,400,000
Effective Tax Rate:	
($3,400,000/$23,000,000)	14.8 percent
Minimum Tax Saving:	
[($23,000,000 x 20%) - $3,400,000]	$ 1,200,000
Tax Impact of AMT:	
Tax Preference:	
(42% x $10,000,000 Exclusion)	$ 4,200,000
AMT Tax (28% x $4,200,000)	$ 1,176,000
Total Tax Including AMT:	
($3,400,000 + $1.176,000)	$ 4,576,000
Effective Tax Rate with AMT:	

Table 2	
Scenario 2a: Gain Is Greater Than Exclusion Amount And Appreciated Property Rule Does Not Apply (Restrictive Interpretation of Exclusion Rule)	
($4,576,000/$23,000,000)	19.9 percent
Tax Savings with AMT:	
[($23,000,000 x 20% - $4,576,000)	$ 24,000

Solution 2A

The Smiths will have a realized gain on the sale of $23,000,000 ($25,000,000 sales price - $2,000,000 adjusted basis in stock). The I.R.C. §1202 exclusion, using a restrictive interpretation, is $10,000,000 (50% of the greater of ten times the adjusted basis of the stock of $20,000,000 or $10,000,000). The non-excluded gain of $13,000,000 will be taxed at two rates. The long-term capital gains rate of 28 percent will apply to an amount equal to the I.R.C. §1202 exclusion, $10,000,000, and the balance of the gain of $3,000,000 will be taxed at 20 percent. Thus, the Smiths will have a tax liability (ignoring the AMT) on the sale of $3,400,000 (($10,000,000 gain x 28%) + ($3,000,000 x 20%) with an effective rate of 14.8 percent ($3,400,000/$23,000,000 gain). The minimum tax savings, excluding the AMT, is $1,200,000 (($23,000,000 x 20%) - $3,400,000).

When the AMT is considered, the tax liability of the Smiths could be increased by as much as $1,176,000 ($10,000,000 exclusion x 42% x 28%) resulting in a total tax liability of $4,576,000 ($3,400,000 + $1,176,000). The effect of the AMT would be to reduce the minimum overall tax savings from $1,200,000 to $24,000 (($23,000,000 x 20 percent) - $4,576,000) and result in an effective rate of 19.9 percent ($4,576,000/$23,000,000). Thus, the AMT reduces the tax savings by $1,176,000.

Table 3	
Scenario 2b: Gain Is Greater Than Exclusion Amount And Appreciated Property Rule Does Not Apply (Aggressive Interpretation of Exclusion Rule)	
Amount Realized	$25,000,000
Basis of Stock:	
Adj. Basis - §1001	$ 2,000,000

Table 3	
Scenario 2b: Gain Is Greater Than Exclusion Amount And Appreciated Property Rule Does Not Apply (Aggressive Interpretation of Exclusion Rule)	
FMV - §1202	$ 2,000,000
Total Gain Realized	$23,000,000
Gain Realized - §1202	$23,000,000
§1202 Exclusion:	
Lesser of:	
(a) 50% of Gain	$11,500,000
Or	
(b) Greater of:	
(1) $10,000,000	$10,000.000
Or	
(2) 10 x §1202 Basis	$20,000,000
§1202 Exclusion	$11,500,000
Gain Equal to Exclusion Taxed at 28%	$11,500,000
Tax @ 28%	$ 3,220,000
Gain in Excess of Exclusion Taxed at 20%	$ -0-
Tax @ 20%	$ -0-
Total Tax Without AMT	$ 3,220,000
Effective Tax Rate:	
($3,220,000/$23,000,000)	14 percent
Minimum Tax Saving:	
[($23,000,000 x 20%) - $3,220,000]	$ 1,380,000
Tax Impact of AMT:	
Tax Preference:	
(42% x $11,500,000 Exclusion)	$ 4,830,000
AMT Tax (28% x $4,830,000)	$ 1,352,400
Total Tax Including AMT:	
($3,220,000 + $1.352,400)	$ 4,572,400

Table 3	
Scenario 2b: Gain Is Greater Than Exclusion Amount And Appreciated Property Rule Does Not Apply (Aggressive Interpretation of Exclusion Rule)	
Effective Tax Rate with AMT:	
($4,572,400/$23,000,000)	19.9 percent
Tax Savings with AMT:	
[($23,000,000 x 20% - $4,572,400]	$ 27,600

Solution 2B

While the overall gain on the sale of the stock will remain $23,000,000, using an aggressive interpretation of the 50 percent gain exclusion will result in an exclusion of $11,500,000. This is calculated by excluding 50 percent of the gain or $11,500,000 (50% x $23,000,000) limited by the greater of $10,000,000 or $20,000,000 (10 x $2,000,000 adjusted basis of the stock). This interpretation results in an exclusion of $1,500,000 more than under the restrictive interpretation. The non-excluded gain of $11,500,000 will be taxed at the long-term capital gains rate of 28 percent. Thus, the Smiths will have a tax liability (ignoring the AMT) on the sale of $3,220,000 ($11,500,000 gain x 28%) with an effective rate of 14 percent ($3,220,000/$23,000,000 gain). The minimum tax savings, excluding the AMT, is $1,380,000 (($23,000,000 x 20%) - $3,220,000).

When the AMT is considered, the tax liability of the Smiths could be increased by as much as $1,352,400 ($11,500,000 exclusion x 42% x 28%) resulting in a total tax liability of $4,572,400 ($3,220,000 + $1,352,400). The effect of the AMT would be to reduce the minimum overall tax savings from $1,380,000 to $27,600 (($23,000,000 x 20 percent) - $4,572,400) and result in an effective rate of 19.9 percent ($4,572,400/$23,000,000).

As can be seen from Scenarios 2A and 2B, the aggressive approach does increase the minimum tax savings (before the AMT) from $1,200,000 to $1,380,000. However, with the application of the AMT the tax savings between the two interpretations is reduced to $3,600. The tabular presentations of the two scenarios are contained in Tables 2 and 3.

Scenario 3

Gain Is Less Than Exclusion Amount and Appreciated Property Rule Applies

To illustrate the appreciated property rule, the facts of Scenario 1 will be utilized with the exception that the basis of the contributed property and its FMV will differ. The basis of the contributed property will remain at $2,000,000 but the FMV will now be $4,000,000.

Table 4	
Scenario 3: Gain Is Less Than Exclusion Amount And Appreciated Property Rule Applies (Restrictive Approach)	
Amount Realized	$ 8,000,000
Basis of Stock:	
Adj. Basis - §1001	$ 2,000,000
FMV - §1202	$ 4,000,000
Total Gain Realized - §1001	$ 6,000,000
Gain Realized - §1202	$ 4,000,000
Gain Subject to §1202 Exclusion:	
Lesser of:	
(a) §1202 Gain	$ 4,000,000
Or	
(b) Greater of:	
(1) $10,000,000	$10,000.000
Or	
(2) 10 x §1202 Basis	$20,000,000
§1202 Exclusion:	
[50% of Smaller of (a) or (b)]	$ 2,000,000
Gain Equal to Exclusion Taxed at 28%	$ 2,000,000
Tax @ 28%	$ 560,000

Table 4	
Scenario 3: Gain Is Less Than Exclusion Amount And Appreciated Property Rule Applies (Restrictive Approach)	
Gain in Excess of Exclusion Taxed at 20%	$ 2,000,000
Tax @ 20%	$ 400,000
Total Tax Without AMT	$ 960,000
Effective Tax Rate:	
($960,000/$6,000,000)	16 percent
Minimum Tax Saving:	
[($6,000,000 x 20%) - $960,000]	$ 240,000
Tax Impact of AMT:	
Tax Preference:	
(42% x $2,000,000 Exclusion)	$ 840,000
AMT Tax (28% x $840,000)	$ 235,200
Total Tax Including AMT:	
($960,000 + $235,200)	$ 1,195,200
Effective Tax Rate with AMT:	
($1,195,200/$6,000,000)	19.9 percent
Tax Savings with AMT:	
[($6,000,000 x 20% - $1,195,200)	$ 4,800

Solution

The Smiths will continue to have a total realized gain on the sale of $6,000,000 ($8,000,000 sales price - $2,000,000 adjusted basis in stock). However, I.R.C. §1202 requires that the FMV of the contributed property, not the adjusted basis, be used to compute the exclusion. As such, the gain for I.R.C. §1202 purposes only is $4,000,000 ($8,000,000 sales price - $4,000,000 FMV of the contributed property). Thus, the Smiths can exclude 50 percent of the I.R.C. §1202 gain on the sale or $2,000,000. This exclusion is below the maximum exclusion limitations (the greater of ten times the adjusted basis of the stock of $20,000,000 or $10,000,000). The non-excluded portion of the gain equal to the exclusion, $2,000,000, will be taxed at the long-term capital gains rate of 28 percent. The remaining $2,000,000 of the gain will be taxed at the long-term capital gains rate of 20 percent. Thus, the Smiths will have a tax liability (ignoring the AMT) on the sale of $960,000 [($2,000,000 gain x 28%) + ($2,000,000 x 20%)] and an effective rate of 16 percent ($960,000/$6,000,000 gain). The minimum tax savings, excluding the AMT, is $240,000 (($6,000,000 x 20%) - $960,000). The gain exclusion is calculated under the restrictive approach but the answer would be the same under the aggressive approach due to the size of the gain.

When the scenario is modified to include the impact of the AMT, 42 percent of the excluded gain of $2,000,000 is treated as a tax preference item subject to a maximum AMT rate of 28 percent. Thus, the tax liability of the Smiths could be increased by as much as $235,200 ($2,000,000 exclusion x 42% x 28%) resulting in a total tax liability of $1,195,200 ($960,000 + $235,200). The effect of the AMT would be to reduce the minimum overall tax savings from $240,000 to $4,800 (($6,000,000 x 20 percent - $1,195,200) and results in an effective rate of 19.9 percent ($1,195,200/$6,000,000). The preceding scenerio is presented in Table 4.

CONCLUSION

I.R.C. §1202 provides a unique vehicle to analyze and compare the fantasy of what appears to be significant tax savings with the reality of the relatively insignificant tax benefits actually obtained. Utilizing these distinctions provides the tax instructor with numerous opportunities to enhance students' problem solving skills and conceptual understanding of the nuances of federal tax law. Through a series of related scenarios, the student can be made aware of not only what is contained in the tax textbook and the Internal Revenue Code but also how the provisions are applied in cases of increasing difficulty. The lack of clarity and guidance in applying many of the provisions in the tax code only further enhances the learning process. Furthermore, teaching the consequences of I.R.C. §1202 provides the opportunity to illustrate the impact of other code sections on tax planning and strategy.

EMPLOYER-SPONSORED HEALTH INSURANCE: EFFECTS ON EMPLOYERS AND EMPLOYEES

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ABSTRACT

On average, nearly 11% of the gross payroll or $5,415 is spent on medically related benefits per employee according to a United States Chamber of Commerce Survey in 2003 (U.S. Chamber of Commerce, 2003). The costs to both the employer and employee are constantly rising and debates are ongoing from conference rooms to Congress. Clearly, health insurance is an important area for employer spending and the employee.

This study will discuss the different factors facing employers and employees in medical-related insurance matters. Both employers and employees should be aware the variety of health plans and the possible problems impacting this critical choice.

INTRODUCTION

Participants in the job market look for several factors when considering employment with a particular company. One of the most important issues, besides the salary, is the health benefit package provided by an employer. However, in today's insurance market, employers and employees are facing a crisis. Employers must recognize how heavily employees value health benefits programs. Further, it is imperative that employers and employees be aware of the factors affecting their selections. Health care costs are on the rise, as well as the number of uninsured individuals. Employers have to weigh the many insurance options while accounting for lower-income employees and future retirees.

First, the study will look at a brief overview of some of the available plans. Next, the problems being faced by both the employee and employer are presented along with statistics that provide a image of the current situation. Following will be findings on methods employers are using to weather the health care crisis and other methods for employees to overcome the inherent problems. A brief summary and conclusion highlight the main points of the study.

LITERATURE REVIEW

Very few articles have been written on this subject as it is currently. The available articles emphasized only one particular factor related to this issue in their study. Elswick (2003) studied compensation-based premiums and profiled companies that are more likely to benefit from their use. She also described several well-known companies and their use of the premium program. Geisel (2002a, 2002b) highlighted the troubles with retiree health plans and emphasized the need for employers to support the economy by offering future retirees some variation of a health plan. Harwood (2002) also contributed information about the importance of offering health care coverage to employees. Economic factors and statistical data are presented along with the discussion. Another important work by Greenwald (2003) offers enlightenment in consumer-driven health plans by describing the implementation, advantages, and disadvantages of those plans. Finally, Trombly (2003) discussed various problems with health care, specifically in the distributing industry. However, his information is relevant across other industries.

Definitions

The following terms and phrases are used throughout the study.

Indemnity - This was once the most common form of health insurance where the employee may use any doctor or hospital at any time and must pay a "reasonable and customary" charge for such services.
Health Maintenance Organization (HMO) - Usually the least costly option for employers, it is basically a prepaid health plan providing comprehensive care for a monthly premium. The insured is limited to participating doctors and hospitals, and the plan requires the designation of a primary care provider.

Primary Care Provider (PCP) - A doctor that is specified by the insured individual to provide service. All referrals to specialists are handled through the PCP. Most insurance plans have a restricted list of physicians.
Preferred provider organizations (PPO) - Similar to an HMO with pre-negotiated rates with health care providers, but with higher premiums. Higher levels of service and expenses are covered when using a network provider and a lower level of coverage when the employee goes to other doctors and hospitals.
Network Provider - Insured individuals are given an opportunity to use any of the physicians or specialists offered by the insurance plan. This option provides greater flexibility than the PCP with a broader group of physicians and specialists available.
Point of service (POS) - Similar to a PPO, but makes use of PCPs rather than network providers. However, non-network physician expenses are covered at the higher level if the PCP referred the patient to the specialist.

THE PROBLEMS WITH HEALTH INSURANCE

The United States, one of the wealthiest countries in the world, seems uncivilized in the eyes of others, like the Europeans because of the U.S. health insurance dilemma. One in every seven people does not have health insurance; however, perhaps surprisingly these people are not the poorest in the country. Most of the poor, disabled, and elderly are insured by the government's Medicare and Medicaid programs. Nearly 41.2 million uninsured Americans are middle-class ("In Sickness and in Health," 2002). While 75% of them have jobs, a third lives in households with more than $50,000 in annual income. Two-thirds are under the age of 35 and most of them have the availability and option of exercising health insurance. Why should so many Americans risk their health and savings when insurance is actually offered by their employers? Most would reply that premiums are too high or they would rather spend their income elsewhere. Since employers are shifting a share of the rising costs of health care to their employees, many employees are simply not choosing to have insurance. Ironically, those individuals are partly to blame for the rising costs that employers must cover since "an uninsured ill person will often leave an illness untreated until it becomes an emergency, at which point federal law requires hospitals to care for them" ("In Sickness and in Health," 2002, p. 26). In 2001, nearly $3 billion was passed onto insured individuals and their employers through increased premiums to cover nearly $24 billion spent by U.S. hospitals to care for uninsured patients that could not pay their medical bills (Trombley, 2003).

STATISTICS ON MEDICAL CARE BENEFITS

The decision to offer medical care benefits to employees dramatically impacts a company's bottom line. In the 2002 Employee Benefit Study performed by the U.S. Chamber of Commerce, employees received an average of $18,254 worth of employee benefits in addition to wages. Figure 1 depicts how a payroll dollar was spent in 2002. The cost of benefits averaged 39% of payroll. Benefits varied significantly between companies and an average of 11% of the payroll dollar is spent on medical benefits. This translates to an additional $5,415 for an employee and does not include the amount that an employee elects to have deducted for a medical savings account.

The most common type of health plan in the survey was the preferred provider organization (PPO) health plans, offered by 67% of participating companies. Thirty-nine percent of the surveyed companies offered a health maintenance organization (HMO) plan while the point-of-service (POS) plans were offered by 18% of the employers and the indemnity plans by only 14%. The most common cost-control methods used by companies included mail-order pharmacy services, used by 57% of participating companies and preadmission certification used by 51%. The study also found that larger companies are more likely to share premium costs through proportional payments where smaller companies are more likely to fully cover premium costs. However, larger companies are more likely to provide a greater share of premium payments for dependents (spouse, child and family) than smaller companies ("2002 Employee Benefits Study," 2003). Hardest hit by insurance increases are companies with fewer than 50 employees. A National Association of Wholesaler-Distributors survey found that the rate increase was 23% compared to those with over 500 employees facing a 16% increase (Trombly, 2003).

INCREASING HEALTH CARE COSTS

A lobbyist group on employee benefit issues unanimously agreed that if health care costs continue to rise at their current rate, employers would be less likely to provide quality health coverage ("The Top Benefits Concerns," 2003). A survey performed by the Kaiser Family Foundation and Health Research and Educational

Trust (see Figure 1 in the appendix) found that health insurance costs for employers increased 12.7% between the spring of 2001 and 2002. HMOs experienced the highest increase in costs this past year (2002), with premiums increasing by 13.3%. Deductibles rose most sharply with PPOs, with in-network deductibles rising 37% in 2002 ("Squeeze on Employer Health Coverage," 2002). Eighty-six percent of the respondents are very concerned about this issue and more than half do not feel that the cost increases will return to a single-digit rate in the next five years ("The Top Benefits Concerns," 2003).

Watson Wyatt Worldwide and the Washington Business Group on Health surveyed employers in the Eighth Annual Survey Report 2003 and found that the median anticipated rate of increase from 2002 to 2003 rose to 15%, leading some employers to fear a double in costs in approximately five years. Figure 2 depicts employer health care costs relative to their budget. The increase in costs have caught many employers by surprise and only 32% of employers feel they are willing or able to absorb increases ("Creating a Sustainable Health Care Program," 2003). See Figure 2 in the appendix.

HEALTH CARE PLANS FOR RETIREES

Another problem that is looming is the decline in employer-sponsored retiree health care plans. As future retirees would be forced to draw upon their own savings to pay health care premiums, little money would be left after paying the increasing premiums (Geisel, J., June 2002). A study performed by Watson Wyatt Worldwide also showed that among 56 large employers, 20% have eliminated retiree health care plan coverage for new hires and another 17% will require new hires to pay the full premium (Geisel, J., Sep 2002).

Employers may feel that they should not bother with this expenditure. However, this decision can cause an economic ripple effect since retirees having to spend their own resources on medical expenses will have less remaining purchasing power. This can be significant since Americans are not adequately saving money for their retirement. As evidenced by 20% of a highly paid group of federal workers in Washington D.C., most people do not take advantage of employer-sponsored savings plans. Additionally, when employers offer lump-sum payments when workers change jobs, employees do not take advantage of tax incentives to roll over those funds into a new savings plan (Geisel, J. June 2002). 80% of employers say that Congress should make providing new tax incentives for retiree health care coverage a high priority ("The Top Benefits Concerns," 2003).

OVERCOMING PROBLEMS WITH EMPLOYER-SPONSORED HEALTH CARE

Some economists believe that a significant part of the problem with rising health care costs is a "disconnect" between consumer (the employee) and payor (hospitals, doctors, etc.). Health care is one of the few services where the consumer is uncertain as to the quality of care and the costs involved, allowing the provider, not the consumer, to drive consumption. The answer to the problem would be to have the employer make sure the employee is a player in the game of health care ("Containing Health Care Costs," 2002).

Employers' Responses to the Problems

Employers pledge to employees that any changes will be temporary and short-term. However, employees fear the changes can easily turn long-term. Short-term cost-saving strategies include cost sharing through co-payments and premium increases, targeted interventions, cutbacks in coverage, and others that are depicted in Figure 3. The chart shows the differences in employers' planned responses to the rising health care costs between 2001 and 2002. Most employers appear to prefer increases in employee co-payments and most troubling, reduce or eliminate coverage ("Creating a Sustainable Health Care Program," 2003). Although these are unpopular strategies with employees, they are clearly preferable to no insurance (Harwood, 2002).

Compensation-Based Premiums

Some employers simply have no leeway in their budget to pay for the increasing insurance rates and are forced to pass the increases on to the employee. Fearing that lower-paid employees will drop their health-coverage altogether, some employers have begun to base health benefit premium contributions on individual's ability to pay. However, critics feel this practice fails to address the rising costs of health care and "can serve only as a temporary fix on the way to a well-designed consumer-driven health plan." See Figure 3 in the Appendix.

There are two designs for compensation-based premiums: creating salary tiers with corresponding contribution levels or basing contributions on a percentage of the employee's compensation. This tier method could possibly result in employees, at the top of their tiers, deliberately not excelling so as to avoid a boost in their contribution payment. With the percentage method, larger companies could modify contribution rates to reflect the market costs for particular locations. Although a disadvantage may be higher administrative costs if the company does not already base other benefits on a percentage of compensation, the participation rate may increase. The larger pool would translate to more insured which would in turn spread the costs. This should translate into a less-rapid less fast-paced growing insurance rate (Elswick, 2003).

TRADITIONAL HEALTH PLANS

Among the traditional health plans available, HMOs, with their smaller premiums, are becoming more attractive, especially among lower-income groups. Although HMOs had been declining over recent years, enrollment has stabilized at about 26% coverage due to the higher concern about health care costs. HMOs are the least costly plan type with an average $7,541 annual premium for a family. Many lower income workers are choosing lower cost plans and sacrificing flexibility rather than paying $1,000 in deductibles and higher co-insurance rates ("Squeeze on Employer Health Coverage," 2002).

Employee Responsibility

Some employers are deciding that the employees should shoulder more responsibility for their health and fitness. They are incurring upfront expenses to design programs to help workers improve their health, resulting in fewer claims and lower costs in the long-term. Some methods that are being implemented include the installation of gym equipment in office buildings, discounts for meeting goals through weight-loss programs, and programs that help individuals stop smoking. These programs work best in companies with a lot of employees, as those with smaller numbers may feel they are easily losing money by dealing with turnover of employees and a fewer amount of people to divide the expenses over.

More importantly, some employers are recognizing that it is necessary more than ever to promote employee wellness and educate employees on the costs of health care (Harwood, 2002). The following checklist developed by benefits specialist, Gary B. Kushner, is useful for employers to identify specific elements in educating employees:

•	Inform employees about the overall purpose of the company's health plan
•	Stress the importance of wellness/prevention programs
•	Identify desired outcomes (What are you asking the employees to do to minimize costs or achieve a healthier lifestyle?)
•	Detail the specific action steps for better plan utilization (colonoscopy or mammography for those in particular risk groups) ("Containing Health Care Costs," 2002).

Kushner also emphasizes that education and communication regarding health benefits should occur on a regular basis and incentives should be built in "where it makes sense," like filling prescriptions by mail order or purchasing generic rather than brand-name prescriptions ("Containing Health Care Costs," 2002).

CONSUMER-DIRECTED HEALTH PLANS

A recent development in health insurance is a move towards "consumer-directed" plans. Under this form of insurance, employees are given a defined budget to cover usual medical expenses and receive standard health insurance with a very high deductible that would be applied if the employee had an expensive medical emergency. Any unused money from the budget would be rolled over to cushion future medical expenses. This plan encourages employees to become more responsible for their healthcare by making frugal health care decisions since they are, in essence, "paying" for their own health care (Harwood, 2002). Plan providers would offer "extensive information on health care treatment and costs to help employees be better consumers of medical services that fall within their deductibles" (Greenwald, J., 2003, p. 1). The consumer-directed plan would be most beneficial for younger and healthier employees who would most likely not have high medical bills during their first few years of employment (Harwood, 2002). The 2003 Membership Survey mentioned earlier found that 58% of companies polled consider it a high priority for Washington to encourage the development of the plans. Further, 73% of employers surveyed believe significant enrollment will occur in these plans when offered in the next five to ten years ("The Top Benefits Concerns," 2003). A survey performed by California Health Decisions found that nearly 85% of employees surveyed from June through December of 2002 had never heard of consumer-directed health plans. As shown in Figure 4, more than six out of ten respondents are willing to manage their own benefits, but no more than a third are willing to pay higher fees. The survey showed that there is very little education in regards to the different options available to employees and that there may be an emerging trend towards these plans. Although consumers do not want additional costs, if traditional plans continue to increase at their current rates, some individuals may be more willing to manage their health costs. See Figure 4 in the Appendix.

Employers interested in this new option are willing to sponsor this form of insurance even if enrollment rates are less than normal - typically about 10% for a new plan.. Pricing, communication, education and advocacy of the plan can help drive participation, as well as word-of-mouth. Strategies may include comparing how health care dollars are spent in comparison with traditional insurance plans, coverage calculators, and educating not just the employees, but their spouses and dependents (Greenwald, J., 2003).

FLEXIBLE SPENDING ACCOUNTS

Another way to retaliate against the rising health-insurance costs is flexible spending accounts (FSA). They are also known as "medical flex plans" because they allow employees to set aside pre-tax dollars each year to pay for certain expenses, such as medical, dental and vision (Harwood, 2002). With the rise of deductibles, FSAs have become more popular, with participation increasing 15% in the first quarter of 2003 compared with 2002 in a report performed by Fidelity Investments (Lee, 2003). The downfall to these plans is that employees must be thoroughly educated as to how to properly use their flexible spending account. If employees do not use the money they have set aside, they lose it (Harwood, 2002). A benefits manager for IBM employees said they leave, and therefore forfeit, about five percent of their FSA balance in their accounts each year. In spite is of that obvious drawback to this plan, President Bush has recently encouraged the use of FSAs by proposing up to $500 of the leftover contributions to be rolled over or deposited into a 401(k) plan for retirement or health expenses at a later date (Lee, K., 2003).

SMALL COMPANIES AND RETIREES OVERCOMING THE PROBLEM

Smaller companies can reduce some benefits costs by combining with other smaller business to form a larger pool through outsourcing organizations or trade association plans. This allows administrative fees and incident claims to be allocated over a larger pool of insured employees (Trombly, 2003). Some small companies are saving money by offering financial incentives for employees to waive health coverage if they can access a plan through another source, like their spouse's program. Sometimes this also helps the employee by spending fewer dollars on insurance for the entire household. This could however be a disadvantage as the employees that do not have another source of insurance may end up having higher deductibles or premiums because of a smaller pool unless they are in some sort of outsourcing organization or trade association (Harwood, 2002). In regard to the issue facing retirees, there are few solutions available. In a study performed by Watson Wyatt Worldwide, employers are typically paying more than 50% of retiree health care costs, including premiums. This figure could be as low as 10% by the year 2031. Some employers feel obligated to continue coverage to some degree for retirees and are "increasingly tying the portion of the premium dollar they will pay to the length of service by the employee, as well as lengthening the minimum service requirements employees must meet to qualify for retiree health care coverage" (Geisel, J., Sep 2002).

SUMMARY AND CONCLUSION

There is uncertainty as to what the future will bring to the realm of employer-sponsored health care insurance. In most countries around the world, "the payment for health care is viewed as a societal issue and paid for by government. The U.S. in unique in that the payment comes from the private sector" (Jusko, J., 2003). To overcome all of the options available to employers, the government may even have a say in what an employer must provide for its employees. The debate over health-care has been long-standing with little consensus between the Democrats and Republicans. A recent development has been emerging among the Democrats that the problem of the uninsured and rising insurance costs should be fixed by requiring employers to cover all their workers while easing costs with government subsidies - a far step from the health care system proposed during Bill Clinton's reign over the White House. The advantage to this plan is that it builds on what already exists - the 160 million workers and their families already insured by their employers. Companies that do not insure all workers would pay a form of tax to help fund the government-sponsored pool of insurance for uninsured employees. On the other hand, Republicans are continuing to sponsor individual coverage with tax subsidies and federal aid making policies affordable, regardless of health or income (Gleckman, H., 2003).

Employers may question the need to continue quality health care coverage to employees as the costs of health care continue to rise at rates that have never been seen before. Most employers understand that healthy employees affect productivity and performance. Research suggests that firms may benefit economically by providing health insurance coverage for workers and their families. Health coverage helps employers recruit and retain high-quality workers:

Individuals will join a company because of its health benefits and will stay with a company because of the health benefits. When competition for workers is strong, health benefits can tip the scale...People who have good memories and loyalty will be out the window for a long time when a company plays with its workers' security for a short-term gain (Quinn, 2003, p. 1).

Healthy employees contribute to productivity by reducing the costs of absenteeism and turnover and by increasing workers' productivity. Despite the increased expenses in health care coverage, an investment on the employers' behalf can achieve a return. Although the short-term effects may appear to be drastic, employers can evaluate the different options available to offset the problems.

Short-term fixes include adjusting the amounts paid on behalf of the employee which may cause more problems in the future. Responses to the ongoing rise in health care may be promoting plans that are cost-friendly: the inexpensive HMOs and consumer-driven health care plans. Small businesses may face more difficulty than larger companies when offering insurance to its employees, however some politicians are making the inequality an issue to allow more competition in the insurance arena. Additionally, retirees are facing problems. However with instruments like flexible spending accounts, ways do exist that allow retirees to use some pretax dollars to pay for medical expenses. Government officials are also taking steps to mend the health care crisis being faced, but there have been no major steps to form a common ground between either political party. Further, it is difficult to predict what the future holds for employer-sponsored health care coverage.

Despite the factors affecting health insurance and a lack of solid solutions, employer-sponsored health insurance is very important to both the employer and the employee. The increasing number of uninsured individuals is one of the factors causing the rates to increase. With any health insurance plan offered, employers can attempt to reduce some costs in the long-run by educating employees about the decisions they can make that affect their health.

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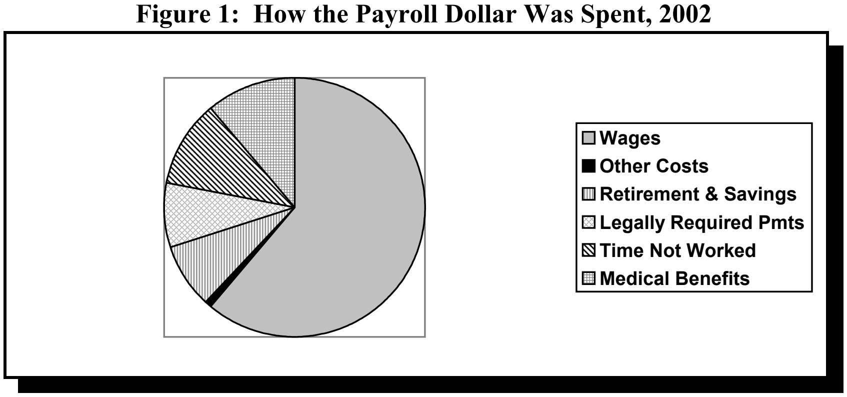
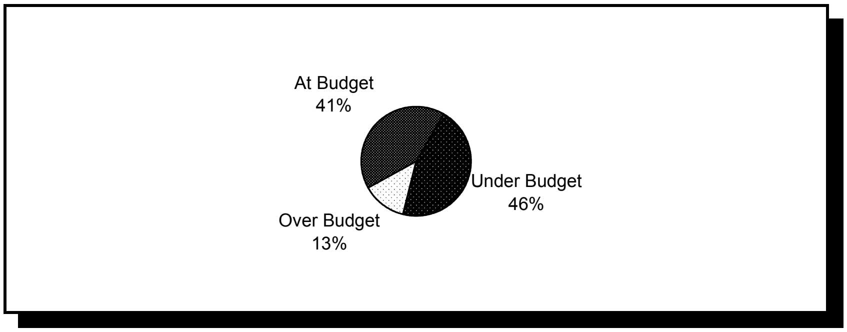
APPENDIX

Figure 1: How the Payroll Dollar Was Spent, 2002



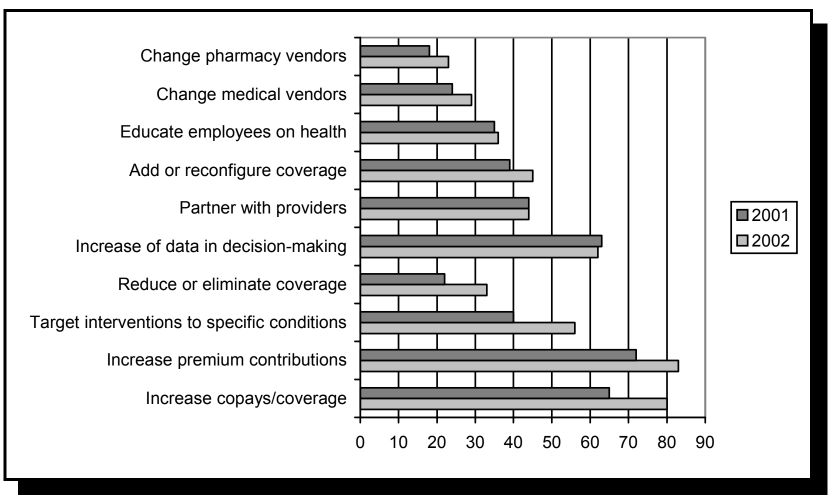
Source: "The 2002 Employee Benefits Study," 2003

Figure 2: Employer Health Care Costs Relative to Budget



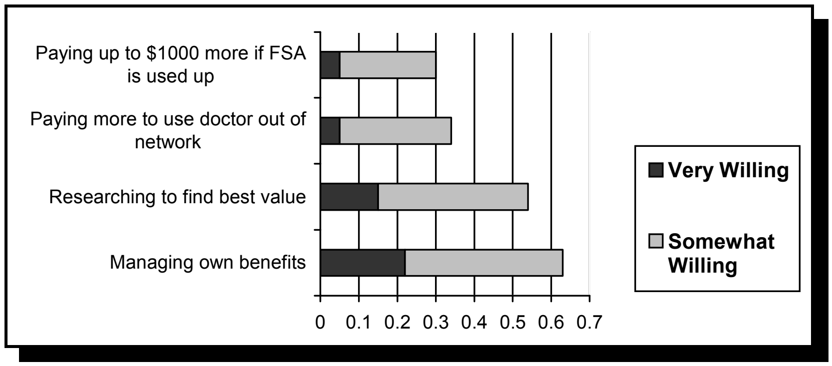
Source: "Creating a Sustainable Health Care Program," 2003

Figure 3: Employers' Planned Responses to Recent Increases in Health Care Costs, 2001 versus 2002



Source: "Creating a Sustainable Health Care Program," 2003

Figure 4: Employee Willingness to Consider Trade-offs in Order to Keep Employer Health Coverage



Source: California Health Decisions, 2003

WHAT ARE THE PRACTICES USED BY SUCCESSFUL ENTREPRENEURS?

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ABSTRACT

This was the goal of this study: Do successful entrepreneurs apply certain specific practices? Presuming success depends on fulfilling some very specific rules, a set of guiding principles was defined. Then, to collect t the data, founder-managers of variety of businesses in Western Maryland were interviewed. As the study indicates, there were no surprises. There was not any sign of a set of pre-specified practices. As time goes by, entrepreneurs may practice any of the recommended rules of succeeding in business. This is exactly what separates the entrepreneurial activities from bigger operations.

INTRODUCTION

Do successful entrepreneurs demonstrate consistent patterns of behavior and or apply certain practices that are unique to them? When compared to lesser successful peers, are they more organized, have written mission statements, clear objectives, and strategic plans? Do they have elaborate marketing strategies and customer relations? Do they maintain their books in order, pay attention to cash flow, and finances? Do they keep good relationships with their suppliers?

It was interesting to uncover these and some other questions, and this research is the result of that inquiry. To minimize any confusion in reading the report, we have to have a good definition for successful and practice.

A *successful* entrepreneur in the context of this research means an individual who has attained wealth, position, and honor in his/her respective community. This implies a qualitative degree of achievement. Therefore, a successful entrepreneur does not need to be in possession of a relatively large, complex, and sophisticated business firm. If the business has survived despite all the odds, if the business has met its goals, if the peers, customers, and suppliers have recognized the business, they have succeeded.

Practice (in the way musicians practice) is not the same as performance. Most organizations promote performance. Performance cultures emphasize on perfection. An organization requires its employees to perform once, perfectly. On the other hand, practice cultures are inviting and participative. The skillful use of practice can lead people to feel inspired and let organizations to seek changes. Through practice, new possibilities for performance emerge (Senge, 1999).

This very emergence of new possibilities exposes us to a fundamental problem. Many small firms follow their free-style of entrepreneurial spirit. The result of this behavior is very little documentation and much dependency on tacit knowledge in carrying out operations. Polanyi (1966) and Nonaka (1995) state knowledge can be either explicit or implicit. The explicit knowledge is formal and codified. Books, databases, and policy manuals are forms of this type of knowledge. The implicit knowledge is informal and uncodified. It can to be found in the heads of their holders. While explicit knowledge deals with there and then, tacit knowledge is about here and now. This is what entrepreneurs in general demonstrate.

METHODOLOGY

For documenting practices and behaviors, during the month of August 2001, fifteen founder-managers of variety of businesses in Western Maryland were interviewed. These firms were involved with small scale manufacturing activities, food processing, plastic injection, printing, and precise tools industry. Number of their employees ranged between twenty and one hundred individuals. All the interviewees were presidents of their respective companies.

These action-packed entrepreneurs allowed many hours of their precious time to this project. Some had to be met several times to make up for the lost time due to normal business interruptions. From a previously prepared questionnaire, questions were read to them, and notes were taken. In addition, to observe how they conduct their operations, they were shadowed.

The required guiding principles came from the Award Criteria applied by the Malcolm Baldrige National Quality Award, the annual award to recognize U. S. companies. Award Criteria goals are delivery of ever-improving value to customers and improvement of overall company operational performance. In addition, the Award Criteria are built upon a set of core values and concepts. These values and concepts represent the underlying basis for integrating the overall customer and company operational performance requirements. These core values and concepts are:

Customer-driven quality: Do entrepreneurs maintain long-term relationships with their customers? Do they include in their relationship with customers such factors as trust, confidence, and loyalty?
Leadership: Do the senior leaders create an environment of customer orientation; promote clear and visible quality values, and expectations?
Continuous improvement: Do they differentiate their products and services from similar offerings and other companies? Do they improve by enhancing values to customers through new products and services, reducing errors, defects, and waste?
Employee participation and development: Is decision-making style autocratic or democratic? Do they practice delegating or not delegating authority? Do they recognize employees for performing their duties well? Do they promote team-work required for growth?
Fast response: Is there any evidence of persistent opportunism: Not passing opportunity for a contract or an offer? Do they apply new or improved work processes to shorten cycles?
Design quality and prevention: Do they pay attention to customer suggestions and comments for the purpose of quality assurance? Do they place strong emphasis on design quality to prevent waste and unsatisfactory product performance?
Long-range outlook: Is there any vision in managing and heading the enterprise? Are there any strategic plans, well-defined goals, and orderly succession process?
Management by fact: Do they analyze data to reveal trends, projections, and cause and effect? Do they practice benchmarking?

Partnership development: Does the entrepreneur "share" his successes with the employees, and therefore nurture entrepreneurial spirit within the company?
Corporate responsibility and citizenship: Do they take into account health, safety and environmental considerations in the company's operations? Do they address factors such as waste reduction and at its source?

What are the benefits of meeting the above core values? According to a series of studies conducted by Commerce Department's National Institute of Standards and Technology, recipients of the Baldrige Award are super performers in their respective lines of business. As the fictitious Baldrige Index indicates, the Baldrige group since 1995 has consistently outperformed S&P 500 by about 4 to 1.

This research is not about quality along the lines of Total Quality Management or other quality programs. The aforementioned core values and concepts were selected because a comprehensive and methodical guideline was needed. No other study has ever used the Baldrige Award's criteria to conduct a shadowing research. A sanguine applicant for the Award must demonstrate that he has met all of the core values and concepts before he takes further steps. In responding to these criteria, each applicant provides information and data on the company's quality processes and quality improvement results. As required by the Award, submission of ample information is required. The experiences and approaches taken by an applicant must be replicable, and their adoption by other companies, possible. The entrepreneurs that were interviewed did not intend to apply for the Award, and were deficient in a good number of criteria. Moreover, purpose of this study was not suggesting how to participate in the process of such a competition. This study meant to explore how business firms succeed in their operations and thrive.

FINDINGS

The result of many hours of talking and listening, taking notes, and shadowing will be demonstrated in the following sections. Whenever possible, the words of people interviewed are quoted to describe the substance of the story and to explain by example essential points. Table 1 demonstrates a summary of the guiding principles, as well as practices of the entrepreneurs who participated in this study.

Table 1: Answers of the Participating Entrepreneurs in this study			
Question	Population	Positive	Percentage
Do you have long-term relationship with your customers?	15	15	100
Do you differentiate your products?	15	12	80
Do you seek feedback from your customers?	15	13	86
Do you consider your leadership style democratic?	15	10	66
Do you promote teamwork?	15	10	66
Do you recognize your employees for quality achievement?	15	15	100
Does your business have a mission statement?	15	5	33
Do you apply strategic planning?	15	7	46
Do you continuously improve your performance/product?	15	12	80
Do you respond to your customers' expectations most of the time?	15	15	100
Do you have a successor?	15	5	33
Do you have training programs for your employees?	15	15	100
Do you provide such amenities as medical care for your employees?	15	10	66
Do you share your financial gains with your employees?	15	7	46
Do you have good relationship with your suppliers?	15	15	100
Do you improve your work processes to shorten cycle?	15	10	66
Do you consider your business a responsible member of the community?	15	10	66

Long-term Relationship with Customers

The length of relationship is the result of customer satisfaction. The typical satisfied customer is inclined toward having a stable and durable relationship with the merchant. That satisfaction is a byproduct of the quality of service provided to him. In other words, quality brings about loyalty.

The first question was "do you have long-term relationship- manifested in forms of loyalty and trust- with customers?" The response of entrepreneurs to this question was affirmative. Some customers have been with one specific company for fifty years! That is the total length of the company's life. This long-standing relationship is not an exclusive privilege of anyone of the observed firms. Many of them were highlighting similar experience. Naturally, not all relationships are stretched over half a century. Some are quite shorter, but for reasons other than customer dissatisfaction: In some instances, a certain customer had a very special, unique need, which was never repeated and relationship terminated.

Is there any advantage in maintaining such relationships? Customer capital (relationships with customers such as the length and depth of relationship and the level of their loyalty) is one of the three broad categories in which intellectual capital can be placed. The other two are human capital (the sum of individual capabilities), and structural capital (the sum of organizational capabilities). The very first benefit of long-term customers is bigger profits. Long-term customers tend to buy more and pay more than new customers do. New customers must be persuaded to switch their loyalty, and that is possible if a discount is offered. The old-time customers create fewer bad debts, and through referrals bring in additional sales. According to consultant Frederick Reichheld, "Raising customer retention rates by five percent points increases the value of an average customer by twenty to one-hundred percent"(Stewart, 1999). We read somewhere else (O'Dell and Grayson) that "rising customer acquisition costs have made companies realize that keeping their customers is their shot at decent margins and sustainable profitability." A defection of customers raise the average cost of production, and that will lead to smaller profit margin and in fact diseconomies of scale.

Nevertheless, a question arises here. What have they done that has created such an intense loyalty? The following discussion casts a light on this matter.

Each company is driven by a set of factors, that is, value drivers. By O'Dell and Grayson's version, these factors are customer intimacy, operational excellence, and product development. The first driver emphasizes on customer support (such as what Home Depot is doing), the second driver addresses convenience (that's the practice of Dell Computers and Hewlett-Packard), and the last one deals with novelty (Texas Instruments and IBM are examples of this value driven factor.)

The customer intimacy is most appropriate and possible when the business environment is less competitive. As competition intensifies, buyer information expands, and substitutes become available, among other factors, customers gain bargaining power relative to the suppliers. This situation leaves no room for the small business but to resort to price competition. This is not a sustainable approach. The best way out of the bind is turning to operational excellence, that is customization, and/or product development.

The next question was "how do you differentiate your products and services from similar offerings and other companies?"

"Customers seek out our services. They call us and ask what we have done lately. In other words, they expect us to have created something new, a novel design, approach, or process." This practice indicates that product differentiation can be used to "lock in" customer loyalty to a specific product. These entrepreneurs have had durable relations with companies Dupont as their loyal customers. Bhidé (2000) in his extensive study of entrepreneurs has reached to this understanding that entrepreneurs can differentiate their offerings by responding to their customers' fuzzy wants. "Because fuzzy attributes allow for multiple interpretations of quality, entrepreneurs can even put a positive spin on their weaknesses." Whenever focus has shifted to price competition, the small entrepreneur has lost to the lowest bidder, normally outside of the United States.

"We are all paid to take risks…we're still on the stage, enjoying the privilege of serving in a supporting role…" is what another entrepreneur proudly proclaimed. He reiterated that innovation has been an important reason why after forty-six years they are still here.

Some of these firms use focus groups. A new product is observed and tested by the group, and if changes are needed, they will be implemented, and then the product is offered to a potential customer.

How do entrepreneurs become aware of their customers' concerns and suggestions? What instruments do they use? Telephone is the first device, "specially if we have not heard from them for a while" or "if they have not responded to our quote." One very innovative entrepreneur has made it a routine to mail wallet cards, each with a piece of advice, along with their price list and catalogue. One of them reads, "Who you do business with…is just as important as the products you buy." Customers respond favorably to these acts of personal passion and persuasion. In addition, these days we see an extensive use of email and facsimile.

Leadership Style

The style of leadership plays a great role in company's success or failure. Some features of a pleasant leadership include democratic decision-making, teamwork, and recognizing employees.

To use an argument forwarded by Block (1996), these entrepreneurs have selected an alternative to leadership: Stewardship. "Stewardship asks us to be deeply accountable for the outcomes of an institution, without acting to define purpose for others, control others, or take care of others." This is exactly what an observer can inspect in these entrepreneurs. They are passionate toward their enterprises. Senge (1990) expresses this state in a different way. These entrepreneurs have a purpose story. "It defines her or his life's work. It enables his efforts…Out of this deeper story and sense of purpose or destiny, the leader develops a unique relationship to his or her own personal vision. He or she becomes a steward of the vision."

In general, their leadership style, as expressed by the entrepreneurs was democratic. Abundant evidence was specified: A reasonable extent of delegation of authority and a fair amount of empowerment were two of the indicators of a democratic leadership style. "The maturity of the employee determines extent of delegation, "said one of the entrepreneurs. That statement aligns properly with the Situational Leadership theory of Heresy and Blanchard (1988). Another entrepreneur mentioned that his secretary/assistant/accountant and the plant manager practically do whatever is needed to run the company.

Cross-functional work teams are standard in the visited firms. This type of team foster cooperation and commitment, and very much liked by the entrepreneurs. However, there was no indication of applying any one of the more known work team varieties such as quality circle. They believed these types of teams are more appropriate for larger firms. Despite this obvious absence of team works, employees are encouraged to share their ideas and act- within limits- on what they suggest. Incidentally, labor unions had no place in these firms.

The next question in this category was "Do you recognize hard work, creativity, and honesty of your employees?" The most common approach, of course, was pay raises, and primarily when a quick response to a customer demand was required. Raises are given across the board, but merit increases are given for exceptional performance, flawless attendance, and quality work. Promotion from within is the customary practice. Successful results are routinely recognized. However, Block cautions against practice of recognition: "We are not donkeys, and some of us do not eat carrots and we don't like sticks."

Some other ways of appreciating employees include pizzas after a great job done by a team and/or a shift, "smiley faces" on paychecks, and gift certificates.

Long-range Outlook

"Achieving quality and market leadership requires a company to have a strong future orientation and a willingness to make long-term commitments to customers, employees, suppliers, stockholders, and the community" Some of the critical components in this regard consist of mission statement, strategic planning, and continuous improvement. These are "necessities" specified by the textbooks and business schools. Absence of these factors leads to absence of strategic direction in large firms. What is the situation in the smaller universe of entrepreneurs?

According to Barreto (Bhidé, 2000), an entrepreneurial firm is to be differentiated from a larger firm because these two operate on two different planes. As such, an entrepreneur works outside the framework of orthodox economic theory because they play entirely different roles. The entrepreneur is the center of his/her own universe. She is the link of the firm. Without her, everything collapses. This is not the situation of the larger firms. Next role played by an entrepreneur is the role of arbitrage. Buy low, sell high. That is the mantra of survival, and impossible to violate. Larger firms, endowed with much larger resources, as matter of fact get into cutthroat competition and price wars. The third role played by entrepreneurs is being innovator. They constantly come up with new methods of production, forms of organization, and products. This flexibility is lacking when the larger firms are observed. Finally, the entrepreneur always faces uncertainty. Uncertainty due to shifts in the market place, as well as limited resources. Encountered with the uncertain world, the solution seems to be ready for any possibility. Therefore, quick, ad-hoc responses will become a normal way of doing business.

Occasionally, even larger, established firms attempt to behave like small, entrepreneurial firms. In doing so, they look very unusual. One of them is Gore Associates, a privately held, multimillion -dollar high-tech firm based in Newark, Delaware. One of the employees in explaining the company's philosophy and performance elaborated on the meaning of long-term planning as applied in their company. "People used to ask me, how do you do your long-term planning…and I'd say, that's easy, we put one hundred fifty parking spaces in the lot, and when people start parking on the grass, we know it's time to build a new plant"(Gladwell, 2000).

What was found about long-range outlook? Some visited firms had mission statements; some others did not. The one with a mission statement says: "It is the mission of…to be honest, straight-forward business, faithful to our customers and faithful to our employees."

A no less assuring message in the newsletter of another company that did not have a mission statement recites: "If you're in business, you've got to do business (generate sales, serve customers and be useful) but…happens to be of the opinion that unless we can also do some good along the way…we're not really paying our way through the only life each of us is going to have."

Some indicated that their mission is implicit. They expressed that they are aware what they are doing; otherwise, they could not have been in business for so long. In fact, this falls directly into what Ackoff (1999) argues. He expresses that a mission statement should not contain "motherhood statements" or tautologies. To say "we provide the best values for the money" is meaningless since nobody expects otherwise.

About strategic planning, most are operating along the lines of Barreto's argument. Trend analysis, projections, financial ratio analysis, and statistical process control as tools of strategic planning are rarely used. Benchmarking is the only instrument used. Vendors are asked about what competitors are doing. Customers are inquired about prices given to them by the competition, and checked if "we are on the same page," meaning we are talking about the same product. Then we investigate why there are price variations.

Ackoff disapproves benchmarking as a tool of planning. He believes "an organization's discovery of the need to benchmark is an indication that something is seriously wrong." As he further defines, what the management should do is focusing on the interactions of parts, rather than the actions of parts taken separately. However, he indicates that only one type of benchmarking avoids such an error, and that is when a business attempts to collect information about the relative performance of its competitors. We saw it is what our entrepreneurs practice.

Asking customers is a direct way of finding information. Customers will often share their information about competitors' services and pricing if not for anything else but for self- interest. This way they can get the best products at the best prices (Kahaner, 1997). Here we are observing a combination of competitive intelligence (CI) and a benchmarking. On the one hand, various available sources, as is the practice of the CI, are explored. On the other hand, a perceived better competitor is copied, or benchmarked.

The management consultant, Stan Davis, asserts entrepreneurs are more businesses than organizations. An organization is defined from the inside out: A chain of command, departments, and processes describe them. However, a business is defined from the outside in: Markets, suppliers, customers, and competitors define them (Stewart, 1999). These entrepreneurs apply a cost-plus method in setting their prices, and require a high margin on whatever they introduce to the marketplace. Nonetheless, they care less about the tools of strategic planning and more about what the customer or competition may think and behave.

The next question was: "Do you have and execute on a regular and systematic basis a quality improvement program?" A quality program normally includes reducing errors, defects, and waste; and improving responsiveness and cycle time performance; improving productivity and effectiveness in the use of all resources.

Our entrepreneurs implement all of the elements of a quality program. Their staffs meet on a regular basis- normally once a week, and in addition, when a new order comes in- to coordinate steps and details of execution such as proper tooling and checking availability and readiness of machines. Cross training of employees is viewed as an effective method of quality enhancement.

Entrepreneurs observed are inventors themselves. A substantial portion of their operating machines are home-built. This has given them capability to fine-tune machines on a daily basis. These alterations have improved their performance and productivity. One of the respondents said "Machines that I built some forty years ago are still minting gold coins for me. The newer machines that we have bought have yet to produce a penny."

How entrepreneurs measure their performance? What are the performance indicators? These are measurable characteristics such as percentage of market share, employee suggestion rates, number of grievances, turnover and absenteeism, number of lost packages and delayed delivery, number of invoice adjustments, and the like. These indicators are normally used to evaluate and improve performance.

For them, employee suggestions are the accepted way of performance measurement. However, no one keeps track of these suggestions, or any other indicator. We should recall the concept of implicit knowledge. Entrepreneurs have a sense of detecting crisis without much market analysis and keeping records of subtle changes that occur in their enterprises. "Three to four years ago, we had a fourteen week lead time over competitors. Not any more such a gap exists between us and others." This was one of the responses. Higher costs of installing expensive machinery, and smaller margins-due to severe foreign competition were named as the causes of this development.

Entrepreneurs indicated that they rapidly respond to their customers' demand requirements and expectations. Their normal approach is establishing a position of customer service, at times an additional responsibility for the receptionist.

Alternative methods observed were newsletters and web pages. One enterprise publishes a quarterly newsletter to inform the customers of the company changes. One of the issues had a very interesting message. It addresses the extent of respect that the customer will expect from this company. The message reads: "There was a time when your phone call was answered by a real, live person. No press this, or pound that. We'll talk." In an attached brochure, this message is repeated: "Just call…we listen…and create tools which help your facility perform better, too."

Patrick Daly, who oversees a customer relations program for a company in California, suggests the following ways to develop extraordinary services: First- Individual, personalized attention, second- custom care, third- keeping in touch, and fourth- reaching out to lost customers to learn why they went elsewhere (Fisher, 1998).

This group of entrepreneurs indeed implements all of the suggested methods. One of these entrepreneurs was trying to convince a large company to supply a small firm with certain materials. Ironically, our entrepreneur had never dealt with that small firm. They had heard that this enterprise is willing to go out of its way just to help. Another entrepreneur periodically sends out a wallet card containing words of wisdom to the customers, just to remind them "we care."

A critical issue that every entrepreneur faces is the succession. The entrepreneurial enterprises visited can be classified into three categories: Old (forty plus years), adult (around twenty years old), and young (less than ten years old).

The older firms are at a stage that the founder is ready to retire. What happens after this phase? Some of these firms have heirs, but unwilling to take charge of the business. Talent and competency are there, but not desire. They have other plans of their own, and pursue other interests. They do not like the region and area, and the like.

Some of these older companies have no heirs. Their only choice, similar to those above, is to find out a buyer, normally located out of the town. There is a remarkable story in this regard. A letter posted on the wall from a potential out of town buyer said: We were ready to finalize the deal until we heard from you and became aware of your constraints. Our plan was to purchase the plant and move it out of its present location to another city in the South. Unfortunately, we discovered that because of your intense loyalty to your employees, you are not willing to close the deal. De Geus (1997) explains the causes of longevity of some firms. "Companies die because their managers focus on the economic activity of producing goods and services, and they forget that their organizations' true nature is that of a community of humans." Handy (1996), recaps that a company is not a piece of property, inhabited by humans; it is a community, which itself has property… communities have members, not employees".

In the same context, De Geus mentions that one of the common factors that contribute to a long life is financial conservatism. This allows them to be flexible and independent to act. They can pursue opportunities that their competitors cannot. An entrepreneur in this study repeatedly mentioned that they are debt free, and have been for a long time. He deplored financial adventurism and was visibly proud to be free of third-party financiers. The same individual could remember harder times. In one occasion, he had to argue with the sheriff who had come to padlock his business. They were in all but official bankruptcy. He reversed the legal attack, but the incident has left very deep scars on his memory.

People are assets of their respective workplace. In a democratic society, we cannot own people's brains. If pressed hard, they can take those brains elsewhere. Keeping these brains demands investing in them. They must be developed and given scope for their talents (Handy). Stated in a different way, development is a mental process. It is primarily a matter of learning (Ackoff). Entrepreneurs are mindful of this important factor, and execute it.

Our entrepreneurs have extensive training programs, some of them required by law. Safety and training how to handle hazardous materials are examples of these requirements. But entrepreneurs go beyond the minimum legal obligation. Employees are sent to supervisory training classes, all paid by the company. If travel is involved, the firm also absorbs those expenses. Entrepreneurs themselves attend seminars and workshops to improve their knowledge and skills. Some years ago, this author and one of these entrepreneurs were classmates receiving ISO 9000 training.

Majority of entrepreneurs applies on-the-job training method. In one case, the trainer, being afraid of the consequences, was reluctant to train the newly hired employee. He was fired prematurely. The new person had already learned enough to fill the position. This person is now the plant manager.

How is the quality of life of employees? By quality of life, it is meant how the safety, health, well-being, and morale of employees are being addressed. Some indicators mentioned to entrepreneurs were health insurance, fitness program, and employee appreciation.

The response of one of the entrepreneurs closely matches two of what Hatch and Gardner identify as components of interpersonal intelligence. These are personal connection and social analysis. Personal connection embraces empathy and connecting. Those individuals who enjoy having this valuable component are able to recognize and respond fittingly to people's feelings and concerns. "At its best, this ability makes one a competent therapist or counselor…"(Goleman, 1995).

The entrepreneur in discussion elaborated on a long list of what they do for the employees. A partial list includes the health insurance and fitness program. However, they exceed these amenities. Others include giving Christmas presents, buying food for the sick employee or an employee who has run out of money. Also, offering counseling when an employee is involved with family problems. Taking employees to hospital when they need such assistance is another display of caring for quality of life. Flextime is considered on a case-by-case arrangement. One entrepreneur proudly referred to their mission statement that reads, "It is our mission to treat our co-workers and customers fairly and with respect, so that all of us can enjoy a good quality of life."

Other entrepreneurs do not share providing these amenities. One indicated that employees ought not to expect any assistance beyond their own wages. Surprisingly, this very same entrepreneur has many loyal employees. There must be other reasons for this loyalty. Quoting Robert Trivers explaining Tit-for-tat, Ridley (1996) says "one reason self-interested individuals might cooperate was because of reciprocity…far from being altruistic, social animals might merely reciprocating selfishly desired favors". It was noted before that some employees have stayed with him for over thirty-five years. The loyalty has been on both sides. That may explain the odd situation. "We are uniquely good at reciprocal altruism. Think about it: reciprocity hangs, like a sword of Damocles, over every human head. Obligation; debt; favor; bargain; contract; exchange; deal…Our language and our lives are permeated with ideas of reciprocity".

In a lengthy discussion about "balancing the wealth", Peter Bloc argues that "The search is for systems that express the idea that wealth is created at every level of the organization and we should pay people as much as possible rather than as little as possible". Not everybody in this research was in agreement with Mr. Bloc. Although some entrepreneurs have profit sharing and bonus plan for management, some others reject the notion of sharing. What they offer instead is more in the line of pay for skills, where an individual employee receives salary increases or a higher hourly wage as she or he performs different tasks. As such, the value of the individual is determined by his/her versatility. Peters and waterman (1982), too, say that people are much more interested in intangible things -winning the praise of colleagues or working for an organization they admire.

About relationship with suppliers, in general, entrepreneurs believe that more than one supplier is needed. Having an alternative is a prudent approach in conducting a business. Entrepreneurs were asked them if they have had acceptable relationships with their suppliers. The overall response was vigorously positive. Majority of the entrepreneurs emphasized on the long-term relationships that they have maintained with vendors, some for over thirty years. They believed such a relationship is a prerequisite for survival. Occasional changes of vendors have caused problems in their performance.

What criteria they consider critical in preserving the relationships with the vendors? These are some of them: Service (such as on-time delivery and laboratory support,) price, and quality, in that order. That was a response expressed by scores of entrepreneurs. However, as the years have passed, for some of them, number of suppliers has increased, less because of spreading the risk, or to ease quality problems, defects, or errors in billing, and more due to increasing variation in activities.

The next question was about strategic partnership or alliances with suppliers. The purpose was to uncover if entrepreneurs had ever used an opportunity to enter new markets for new products and services. Those involved with industrial activities were certainly in such a position. What were their responses? "When a new supplier comes with a new product, kind of unfinished, we help them to get into business." Expressing this statement coincided with a telephone conversation between an entrepreneur and a supplier from California. The man over line, unable to acquire certain material for further processing from a third person, was asking our entrepreneur to connect him with a certain firm. He agreed. Why did he do it? "A possible spillover sometime in the future" was his justification.

Fast Response

"Success in competitive markets demands shorter cycles for new or improved product and service introduction. The competitive market also requires taking advantage of opportunities that arise in the marketplace."

Entrepreneurs were asked to itemize evidence of persistent market opportunism. These are what they mentioned:

Introduction of new (or modified) products: One newsletter says "innovation means letting your people take chances, backing them when they win and supporting them if they lose." The entrepreneur said this is our motto. Yes, we invent and innovate, continually.
Entering new markets: Specifically Australia, France and England were referred to.
Acquiring new customers.
Accepting new offers and signing new contracts: German and Mexican companies are trying to acquire for license certain practices and methods from them.
Finding new partners: In two cases, Dupont was mentioned.
How do these entrepreneurs seek new markets and customers? In other words, how do they become informed and inform others?

The evidence of competitive intelligence included telephone calls (extensively), attending trade exhibitions, publishing newsletters, maintaining web sites, and being in touch with trade representative. Advertising came last, and very negligible. Assistance of salespeople was not mentioned at all.

Corporate Responsibility and Citizenship

"Corporate responsibility refers to basic expectations of the company-business ethics, protection of public health and safety, and the environment. Companies need to address factors such as waste reduction at its source" to be considered good citizens.

The following question inquired if entrepreneurs support-within reasonable limit of their company's resources-public education and awareness, resource conservation, community services, improving industry and business practices.

In a paper presented at the Academy of Management we read: "The entrepreneurial CEOs were found to be more economically driven and less socially oriented than their large-firm counterparts. Apparently corporate social responsibility is a luxury many small growth firms believe they cannot afford" (Longenecker, Moore, & Petty, 2000). The findings of this study support this understanding. However, a small minority displays very unusual strong commitment to the improvement of society. One entrepreneur was proud of his record in all sorts of socially and environmentally inspired activities. "We lose money for recycling.

We have tons and tons of scraps. We can legally dump them in landfills. We refuse that practice. We pay a worker to grind the plastics. Then we sell them for two or three cents per pound for further processing. These scraps are turned into plastic "woods." Park benches are being made out of them."

Entrepreneurs are very active in civil activities; they are involved in college and industry affairs, and many charitable engagements. One has already set aside his quite large house for his church whenever members retreat or have spiritual activities. Another one at the tenth anniversary of each employee hands him/her an envelope containing one thousand-dollar.

CONCLUSION

To conduct this research, a group of entrepreneurs was asked to reveal secrets of their success. Assumption was that they adhere to a set of guiding principles that constantly point to a very specific direction. It became obvious that such a distinct guideline is more illusionary than real. Certain practices, of course, are of great value in success. However, not everybody applies those principles, and not everybody believes in them.

The business firms investigated in this study are far from the Baldrige standards. The founders were well aware of this reality. However, if you cannot be a Baldrige Award winner, or even being considered a candidate for the Award, you still can be successful, experience a healthy business operation, and expect a long-life for your business. You do not even need to go by the book or observe rigid rules to survive. As the responses of our entrepreneurs testify, flexibility and playing by a different set of rules, as demanded by distinct conditions, are required standards for staying on the correct business path. Nevertheless, the study explains that a few of the requirements are basic and their execution mandatory. Customer satisfaction, long-term relationships with suppliers, and good product development and distribution are the ones that ought to be strictly observed. Having mission statements, application of teamwork, and sharing with the employees, although useful and in cases morally correct, are not the necessary rules of the business success.

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BUSINESS-LEVEL STRATEGIC CHOICE IN LOW MARKET-SHARE FIRMS: AN EMPIRICAL ANALYSIS

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ABSTRACT

The relationship between a firm's strategy and its performance is an important theoretical as well as pragmatic topic. Strategy is generally considered to have two components -- a corporate level or product/market Choice; and a business level that focuses on the firm's resource deployment vis-à-vis the competition.

A review of the strategy literature quickly shows that the overwhelming majority deals first with the process of determining the product/market choice as opposed to the strategic content; and secondly, that the subjects are predominantly large manufacturing firms rather than smaller low market share companies.

The purpose of this paper is to empirically investigate the relationship between business level strategies and performance in selected low market share retail firms.

PREVIOUS RESEARCH

The influence of market share leadership on performance has long been challenged by rich body of research (e.g., Rumelt and Wensley , 1981; Woo, 1981; Ziethaml, et. a1., 1981). Woo and Cooper (1980) admonish researchers to remember that "most businesses are not market leaders" anyway. For the vast majority of businesses therefore, market share is a useless springboard from (or toward) which to build effective strategies. Indeed, in most low-market-share oriented paradigms, low market share firms are offered little choice other than harvesting, divestiture, and liquidation as recommended strategy options.

A few researchers in this body of research offered encouraging direction to seekers of effective strategies for low market share firms. Hammermesh, Anderson and Harris (1978) identified four general strategies including: creative market segmentation; controlled growth; good management; and efficient R & D expenditures, for low market share firms. However their efforts provide minimal external validity (N = 3) and recommendations that are so broad that their operational value is quite limited. Woo and Cooper (1980) provided strong support for the notions of Hammermesh, et. al. with a study of greater external validity (N = 126) and providing greater specificity in the identification of effective strategies for low market share firms. They found that within the chosen product-market environments, selective focus on specific strengths best described the competitive strategies of effective low market share businesses -- intense marketing, high product value and careful cost control represented the orientations of effective low share firms.

The Woo and Cooper (1980) study makes an important contribution to the strategic management literature by empirically confirming the existence of distinct strategies that are far removed from the harvest, divest or liquidate prescriptions of market-share based paradigms. More work needs to be done, however. For one thing, Woo and Cooper's findings of "intense marketing, high product value and careful cost control" are still rather broad strategic guidelines with limited operational value. Second, much of this earlier research used the PIMS (1977) data base, which contains mostly large manufacturing firms. The generalizability of their findings to the largest number of low share businesses, small to medium sized retail and service firms, is questionable.

This current study sought to enhance the previous research regarding strategies of low share firms by empirically identifying specific strategic variables, and their impact on performance, around which to build effective strategies in small retail firms. Following SBA standards, a firm was defined as small if its annual sales were less than $5 million and the firm was independently owned and operated.

STRATEGIC VARIABLES IN SELECTED SMALL RETAIL FIRMS

In order to identify potential "strategic" variables for subsequent analysis with regard to effective strategies of selected small retail firms, a review of past retailing studies was necessary. They are reviewed briefly in eight categories: Hobby/Toy/Crafts; Gifts/Nove1ty/Souveniers; Books; Jewelry; Food and Food Service; Men's and Boy's Clothing; Women's Clothing; and Shoe Stores.

Milton Grey, past president of the Hobby Industry Association, says that a Hobby/Toy/Craft store should have four attributes: experienced management with at least fundamental business skills; high volume traffic location; promotion; and adequate working capital in order to stock up for the major selling season between August and January. Darden, Miller and Carlson (1981). in a study of sex-role orientation and patronage preferences, found that with respect to toys, that women, especially from higher income groups, are more likely to patronize this type of store.

The price/value relationship, store specialization, quality of merchandise and services available, are listed as the top four determinants of patronage in a Gift/Novelty/Souveneir store by Jolson and Spath (1973). Like Hobby stores, Darden, et. al. (1981), found that women were significantly more influential in store choice than were men. In this same vein, Gentry (1980) profiles the typical Gift shop consumer as female, 25 to 50 years of age, and in the upper income groups. He found the typical Novelty/Souvenir consumer to be female, between 19 and 25 years old, single, and in the lower income groups.

The American Booksellers Association (1978) reports that "There is surprisingly little difference in gross margin between profitable and unprofitable stores." It is precisely this profit margin (or lack of it) that makes the role of the management so critical. In a market survey for the American Booksellers Association, the accounting firm of Ernst and Young (1968) report that the successful criteria for 'bookselling is (again): sound management, location, customer service and lease/rental rates. The Small Business Administrations booklet on bookstores (1974) further supports these findings.

In the Jewelers Circular Keystone (1977), a trade magazine, it is reported that image in a jewelry store is the most critical issue related to success. Jolson and Spath (1973). find that image is a three-way proposition, that the price/value relationship, store specialization (i.e. deep assortment, lack of congestion, personal identification, etc) and quality of the merchandise are the most pertinent aspects of image. Darden, et. al (1981) also found that the sex of the shopper was inversely related to the type of item purchased, that women were more influential in purchases for men, and vice versa.

Woodside (1973) examined the patronage motives for purchasing products at a particular restaurant location. His purpose was to identify possible changes that could be made in the store marketing strategy. He found that after food quality, location was the primary reason for patronage, followed by advertising (image) and service. Lastly, he found that price perceptions were highly correlated to patronage. The notion of location is consistent with Fauld and Gruenewald's (1981) finding that within the location dimension that accessibility, visibility, proximity to residence or place of work or other frequently visited establishments, along with cleanliness, all contribute significantly to performance. Tigert and Arnold (1981) also found that location, price and courteous service were consistently the most important characteristics of patronage in restaurants.

Darden, Miller and Carlson (1981) in their study of influence on patronage preferences found that women were more influential in the choice for both children's and adult male clothing purchases. Tigert and Arnold (1981) found that when choosing a fashion outlet, the top determinant attributes are: value and assortment, quality, location/convenience and service. James, Durand and Dreves (1976) have done the most extensive analysis of men's clothing stores. They identified six attributes that had significant impact on whether a consumer would choose one store over another. They were: service, personnel, quality, assortment, price and atmosphere.

Not surprisingly, those factors inherent in patronage choice for men's clothing, are also present in the patronage choice for women's clothing. Again, Tiger and Arnold (1981), give the attributes of preferred fashion outlet as value and assortment, quality, location, convenience and service.

Claxton and Ritchie (1979), found that women choose a retail fashion outlet because of the sales staff, merchandise selection and in-store conveniences such as the availability of credit. Credit availability was also shown by Smith (1981) to be a prime factor in patronage in his study of purchases in women's departments of large department stores. Jolson and Spath (1973) however, have done the most extensive work on the factors of patronage specifically with respect to women's apparel shops. They were able to rank order the most important factors of patronage as: price/value relationships, assortment and variety, quality of the merchandise, service and location.

According to the National Shoe Retailing Association (1977) over 22% of all shoe sales are purchased using credit of some description. The availability of credit as a reason for patronage is consistent with the findings of Claxton and Ritchie (1979). They investigated the consumer purchase decisions and found that in women's shoes, in-store conveniences were second only to the quality of the merchandise as a decision criteria for shopping in a particular store. Phillip Kotler (1973) found that for shoes, variety, in-store promotion, assortment- and aesthetics are the most important reasons for shopping in a particular store. Jolson and Spath (1973) reinforce these findings in a study that showed that retailers prime considerations are with variety and assortment, and location. They also found that consumers had the same order of priorities, selection and location. Lastly, Miller and Gentry(198l) found that men and women overwhelmingly preferred and purchased from specialty shoe stores. They felt that a specialty store would he in a better position, and thus more likely, to provide the service and quality demanded by the consumer.

In summary, current retailing theory and patronage theory classifies performance in selected retail firms as being a function of several "strategic" variables. These variables are summarized in Table 1 below.

Table 1: Summary of Variables Related to Performance in Selected Retail Firms

	Hobby, Toys & Crafts	Gifts, Novelty & Souvenirs	Book-stores	Jewelry Stores	Food & Food Service	Men's & Boy's Clothing	Women's Clothing	Shoe Stores
Location	X		X		X	X	X	X
Traffic Levels					X			
Lease/Rental Rates			X					
Marketing	X		X		X			X
Personnel						X	X	
Financial Position	X							
Service		X	X		X	X	X	
Convenience		X					X	X
Special-ization		X		X		X	X	X
Quality		X		X	X	X	X	X
Price		X	X	X	X	X	X	
Credit			X				X	X
Management	X	X	X		X			
Consumer	X	X		X		X		X
Image				X	X			
Atmosphere						X		X
Size or Number of Stores								X

Following this literature, the study sought to determine which of the variables summarized in Table I were "strategic" for selected retailers in the sense of being strongly associated with performance.

METHODOLOGY

Sample

The sample used in this study were those small retail firms located in eleven shopping centers in a large southern metropolitan area of approximately 400,000 persons. These centers house 320 retail firms. Major multi-department retailers such as Sears, Penny's, Rich's and Belks were excluded.

The resulting sample consisted primarily of locally owned single-store operations and locally owned multi-store operations. Regional and national chain stores were included to the extent that they were single-product in scope (i.e. franchises).

Variables

The dependent variable in the study was the adjusted sales per square foot. This control was necessary to establish a standard performance effectiveness basis by which to compare firms. Independent variables are listed below in Table 2. In order to try and capture and measure potential
"strategic" variables for effective retailing as suggested from the literature review -- multiple measures were employed were possible.

Table 2: Independent Variables

Location:	Distance consumer lives from store (miles and minutes); Parking spaces per store; Number of perceived competitors
Traffic:	Traffic count
Lease Rates:	Base lease or rental rate
Marketing:	Advertising dollars (media and in-store); Percent of sales used for advertising; Contribution to merchants association; Hours open per week

Table 2: Independent Variables	
Financial Position:	How often financial data received; Change in net assets per year; Number of months operated before showing profit; Total sales; Average paying customers daily; Average sale per customer
Personnel:	Number of employees
Consumer:	Percent of consumers who shop this store for Service; Convenience; Specialization; Quality; Price/Value; Credit Availability; Other
Consumer Demographics:	Age; Sex; Marital Status; Income
Management:	Age of the owner/manager; Sex; Years of experience; Years of education; Hours per week devoted to business the first year of operation; Hours per week devoted to business presently; Years owned present business
Planning:	Number involved in the planning process; Number in the planning that make decisions; Future planning before opening business in months; Number of months ahead planning done presently; Number of trade journal subscriptions; Number of man days planning per month

Data Collection

Data collection was done in three phases. Phase I was a questionnaire guided interview of consumers at each shopping center location that sought responses to the consumer related variables listed in Table 2.

Questions included were concerned with the consumer demographics, frequency of shopping in a particular store(s) and store(s) shopped, and the reasons for shopping at that store(s). Interviews were conducted on each shopping day of the week over a six week period. Interviews were conducted on Monday the first week, Tuesday the second, and so forth. There were 6,251 responses gathered.

Phase II was a questionnaire given to individual store owners of the manager of each firm in the sample. The questions dealt with the characteristics of the owner/manager as well as the financial, marketing, operational, competitive and planning aspects of the firm identified in Table 2 as potential "strategic" variables. There were 139 usable responses received.

Phase III of the data collection was completed by the researchers. Data dealing with traffic flows, square footages and lease or rental rates, was gathered from the highway department and from the respective mall/center management offices.

Analysis

The analysis used stepwise regression. Inclusion of variables was continued until the adjusted R value began to decline or the ratio of observations to included independent variables reached three to one.

RESULTS

According to the literature, location, marketing, financial soundness, managerial abilities and sex of the consumer were thought to be the most influential variables with respect to performance in Hobby/Craft/Novelty stores. Table 3 below show the results of the analysis.

Table 3: Hobby/Toy/Craft Stores

Dep. Var. - $ Sales/Square Foot	Variables in the Equation	B	F
R Square = .99	Age of the Manager/Owner	2.10	277.33**
Adj. R Square = .98 F = 175.79**	Hrs/Wk devoted to business in the first year	0.99	88.17**
N=7			
* Significant at p = .05			
**Significant at p = .01			

With a large amount of the variation in the dependent variable explained, The exp1anitory variables are consistent with what Milton Grey, the past president of the Hobby industry said was the first most important attribute of a store of this type, "Experienced management with at least fundamental business skills."

Gift/Nove1ty/Souvenir stores performance was thought to be most related to service, convenience, quality, price/value, specialization, management expertise and the sex of the consumer. The results of the regression are given below in Table 4.

Table 4: Gift/Novelty/Souvenir			
Dep. Var. - $ Sales/Square Foot	Variables in the Equation	B	F
R Square = .91 Adj. R Square = .87 F = 19.12** N = 9	% consumers with income of 5-10K per year	0.66	27.22**
	% consumers with income of 20-25K per year	-0.71	27.08**
	% consumers looking for a specific product	0.56	16.93**
* Significant at p = .05			
**Significant at p = .01			
NOTE: Seven of the nine responses in this sample were of the 'novelty' store variety.			

Again a large portion of the variation in the dependent variable is accounted for by factors consistent with predicted variables. First, Gentry said that the shoppers in Novelty/Souvenir stores were predominantly female, younger, single and in the lower income groups. Secondly, specialization was reported by Jolson and Spath as being of primary importance with respect to performance.

In Book Stores, performance was expected to be related most to location, lease/rental rates, marketing, service, price, credit and managerial skills. The results are shown below in Table 5.

Table 5: Book Stores			
Dep. Var. - $ Sales/Square Foot	Variables in the Equation	B	F
R Square = .99	Parking Places per Store	1.57	205.03**
Adj. R Square = .98 F = 199.70** N = 6	Number involved in the Planning Process that Make Final Decisions	9.47	98.49**
* Significant at p =.05			
**Significant at p = .01			

A high degree of variation in the dependent variable is accounted for by the independent variables. Those included variables indicate location and managerial expertise, expecially planning, is directly related to performance in book stores.

In Jewelry stores, specialization, quality, price/value, image, and the sex of the consumer are expected to be the prime determinants of performance. The results are shown below in Table 6.

Table 6: Jewelry Stores

Dep. Var. - $ Sales/Square Foot	Variables in the Equation	B	F
R Square = .80	Yrs Owned Present Business	-13.86	3.47
Adj. R Square = .71	Yrs Experience or Mgr/Owner	-6.37	11.53**
F = 8.19**	% or consumers who shop for Quality	-135.73	2.42*
1 Significant at p = .10			
* Significant at p =.05			
**Significant at p = .01			

Even though a large proportion of the variance is the dependent variable is accounted for by the model, the variables in the equation, while consistent with the prevailing theory, have signs that indicate the influence to be the opposite of what would be ultimately expected from the literature.

In Food and Food Service, location, traffic count, marketing, service, quality, price, management and image are all expected to affect performance levels. The results are given in Table 7 below.

Table 7: Food and Food Service			
Dep. Var. - $ Sales/Square Foot	Variables in the Equation	B	F
R Square = .85 Adj. R Square = .79	Hrs/Week Devoted to Business Manager/Owner	6.74	13.29**
F = 15.27** N = 12	Number in planning Process Who Make Decisions	52134	7.56**
	Planning Horizon - Months	11.62	3.49[1]
1 Significant at p - .10			
* Significant at p - .05			
**Significant at p - .01			
NOTE: 11 of the 12 responses were from fast food/snack type firms.			

All of the variables in the equation relate to management's willingness to put in long hours
and plan for the future of the business.

In Men's and Boy's Clothing, location, personnel, service, specialization, quality, the consumer and the atmosphere are all expected to impact on performance. The results are given below in Table 8.

With 84% of the variance accounted for by the model and a significant overall equation, critical variables have been identified. Two of the variables center on managements ability to plan, one with location and one with the income levels of consumers. All of the variables are consistent with the expectations expressed in the literature.

In women's clothing, similar to men's and boy's clothing, location, store personnel, service, convenience, specialization, quality, price and the availability of credit are all expected to impact on performance. The results are shown below in Table 9.

Table 8: Men's and Boy's Clothing			
Dep. Var. - $ Sales/Square Foot	Variables in the Equation	B	F
R Square = .84 Adj. R Square = .78	Number Months Planning Before Opening	4.30	16.76**
F = 12.55** N = 14	Number Man-days Planning Per Month	0.37	17.99**
	% Consumers who Shop for Convenience	171.81	5.19**
	Consumers with Income Over 25K/Year	1.05	3.75**
* Significant at p - .05			
**Significant at p - .01			

Table 9: Women's Clothing Stores			
Dep.Var. - $ Sales/Square Foot	Variables in the Equation	B	F
R Square = .76 Adj. R Square = .59 F = 4.45** N = 18	% Consumers with Income 15-20K/Year	1.15	3.69*
	Sex of Manager/Owner	104.14	13.64**
	% Consumers who Shop for Personal Attention	610.14	13.52**
* Significant at p - .05 **Significant at p - .01	Daily Traffic Count	.003	10.7**
	Hrs/Wk Devoted to Business First Year	3.54	6.97**
	% Consumers With Income 10-15K/Year	-1.79	4.05*

Variables in the equation that are "strategic" in women's clothing shops --- include service. location, personnel and specialization, as predicted. Also consumers in the upper income brackets (expected in specialty stores) and the sex of the Manager/Owner (again consistent with women specialty shops) also contribute to higher performance.

In Shoe stores, location, marketing, convenience, specialization, quality, credit availability, sex of the consumer, atmosphere and the size or number of outlets are expected to be related to performance. The results are shown below in Table 10.

Table 10: Shoe Stores

Dep. Var. - $ Sales/Square Foot	Variables in the Equation	B	F
R Square = .78	% Female Shoppers	1.63	9.5**
Adj. R Square = .68 F = 7.98**	% Consumers Who Shop for Service	633.48	14.6**
N = 17	% Consumers \who Shop for Quality	285.73	6.9**
*significant at p _ .05	Distance Consumer Travels to get to Store-Miles	-7.15	8.4**
**significant at p _ .01	%Consumers With Income of 5-10k/year	-1.23	4.2*

The actual variables that enter the equation are consistent with what is expected. Sex of the consumer and customers who shop for quality and service are positively related to performance. Location (distance in miles traveled by the consumer) and lower income groups of consumers were both inversely related to performance.

DISCUSSION

Perhaps the overriding question of this research was whether or not the identification of variables, or sets of variables, that influence performance can, in fact, be accomplished in order to facilitate planning in small retail firms. The research results lead to the conclusion that a significant portion of the sales performance can be attributed to certain variables that are controllable by management.

Space prohibits a discussion of all eight categories, but Shoe stores and Jewelry stores offer two of the most interesting profiles in this research. Female shoppers, as expected, exert the most influence on store patronage for shoes. The primary enticements come in the form of services offered by the individual store and the quality (perceived or otherwise) of the merchandise.
Location is a prime influence as the shorter the distance traveled to a store (i.e. the more dense the trade area). the higher are sales in shoe stores. Lastly, shoe stores, at least in shopping center locations, do not appeal to lower income groups.

Jewelry stores are the only group in the study that offers results contrary to that proposed in the literature. While the statistical significance of the predictors are themselves suspect, the equation is significant and explained variance is significant (R2 =.80). The first and second predictors were concerned with the experience of the manager/owner and years the he/she owned the business. The final predictor was the number of consumers that shopped for quality. Each of these predictors however were inversely related to performance. According to the literature, the perception of quality is a prime factor in the consumers patronage choices. Given the cost of jewelry, price may in fact be the prime consideration, with the lower cost being paramount in the minds of the consumer. It is evident also that the experience of the manager/owner does not necessarily have to have been years in the making. A skill in marketing, merchandising, and/or the projection of a youthful image may be more or an advantage than the ability to repair watches or create jewelry. Half of the sample were well established older firms while the other half were less than five years old and in the researchers opinion, were of the high-volume variety. It is conceivable that a shift in the strategic emphasis of jewelry stores from high quality-high profit-low volume to lower quality-lower profit-high volume is beginning to occur.

CONCLUSIONS

In conclusion, this research has given rise to two issues. First, it is clearly evident that all small firms are not alike. Implications for strategy are that different strategy variables have to be addressed with respect to the performance of each. A universal formula for success in small low-share retailers is not available. The research supports the notion of Hammermesh, et. al. and Woo and Cooper in that: (1) there are indeed alternatives to the standard low market share paradigms of harvest, divest or liquidation and (2) that an increased amount of specificity is possible in terms of "strategic" variable identification when the sample size is large and homogeneous enough. From a pragmatic standpoint, it is incumbent upon the manager/owner to clearly identify what variables under his control can be manipulated in order to improve the chances for success.

Secondly, that those factors that influence performance in small low-share retailers appear to be much less complex than in larger firms. This is important because strategic planning is not usually done by an elite group of top level management in smaller firms. There is rarely extensive time or financial resources available to devote to a complete written statement of mission, objectives, goals and policies (not that they would necessarily want one) for the firm. The smaller firm usually does not have one or more of the functional areas to contend with when planning. Subsequently, the key to success could very well hinge on the exploitation of a particular distinctive competence that results in higher levels of performance.

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